HIGH INTEREST RATES

HEARING

BEFORE THE

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CONGRESS OF THE UNITED STATES

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HIGH INTEREST RATES

FRIDAY, SEPTEMBER 25, 1981

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 9:05 a.m., in room 2154, Rayburn House Office Building, Hon. Henry S. Reuss (chairman of the committee) presiding.

Present: Representative Reuss and Senator Sarbanes.

Also present: James K. Galbraith, executive director; Louis C. Krauthoff II, assistant director; Charles H. Bradford, assistant director; William R. Buechner, professional staff member; and Judith Davison, staff assistant to Senator Sarbanes.

OPENING STATEMENT OF REPRESENTATIVE REUSS, CHAIRMAN

Representative REUSS. Good morning. The Joint Economic Committee will be in order for its consideration of high interest rates.

Last night President Reagan on national television explained to the American people why new budget cuts and tax increases are needed only 6 weeks after Congress gave the President virtually his entire economic package. The President's speech left many questions unanswered, so we are particularly pleased this morning to have before us the Chairman of the Council of Economic Advisers, Murray Weidenbaum, an old and valued friend to this committee, to answer some of them.

Most important, why are we in this mess? The economy, except for the level of interest rates, is performing about as well in 1981 as the administration said it would, when the economic recovery program was passed, as economic adviser Jerry Jordan told this committee yesterday, so it is not general economic conditions which have widened the budget deficit and pushed the President into his request for new cuts.

This leaves two possibilities. The first is that the President knew all along that his budget deficit estimates were too low. The second is that the deficit is here because of the increased level of interest rates. But interest rates are unexpectedly high because the Congress accepted the President's program. This leads to the unavoidable conclusion we should jettison the President's program and enact in its place a sensible program. Interest rates would come down and we wouldn't be facing the choices we face today.

Second, what happened to the glowing forecast of last spring and summer that interest rates would fall as soon as the President's program was enacted? What happened to the forecast which underlay

the mid-session budget review of July 15 of 3-month Treasury bill rates at 12.1 percent in the fourth quarter of 1981 and down to 9 percent by the fourth quarter of next year?

What, in short, happened to supply side economics?

Three, what happened to the safety net that we were told would be preserved under the Reagan program? We were told, for example, that Head Start was a good investment in America's children; now it is to be brutally cut. Has the administration found out something it didn't previously know?

Similarly, last night the President spoke of the need to eliminate the black market in food stamps. What black market? How big is it? Who organized it? Where is it? What does it do? If there is any new evidence that such a market exists, where is it? And why did it escape the first round of cuts?

Finally, the President proposes to cut back even further on school meals "to the affluent." How many affluent children does the administration think will eat a school lunch which consists, as it will under the President's new regulations, of a cocktail hamburger, half a roll, a dab of catsup, a bit of relish, six french fries, and three-fourths of a glass of milk?

Four, the President proposes to reduce discretionary non-Defense expenditures by 12 percent, while reducing Defense expenditures by less than 2 percent, or to a level about 1 percent higher in nominal dollars in fiscal year 1982 than that proposed in the Carter budget. This raises two questions. First, why has the administration effectively adopted the Carter Defense budget for fiscal year 1982, after having said so long and so often that it was inadequate and if, as I suspect, even the Carter budget contains large amounts of waste, fraud and abuse, why doesn't the administration want to cut as much fraud in the Pentagon as in the programs which provide food, housing and education to the poor and infirm?

Five, yesterday, just an hour before the President spoke, the Senate voted itself and top civil servants a pay raise. What is the administration's position on that one? If a senatorial pay raise different in budgetary impact from appropriations for Head Start programs, for legal services, for school lunches and 100 other programs which help the poor and needy?

What matters is the level of interest rates and the size of the tax cut for the wealthy that the President asked for and got last summer. And everybody knows it.

The President said last night that he recognized that "Many in Congress may have other alternatives," alternatives to the mean-spirited program which he proposed and that he welcomes a dialog. Well, here goes. The alternative is to roll back and cut back the President's exorbitant tax giveaways to the rich. These were justified only 2 months ago by claims about their effects on work, saving and investment. No one, not even the President, if last night's speech means anything, believes any more that these effects will happen.

It is time that the Congress got right down to the task of correcting the mistakes we perpetrated last summer.

Mr. Weidenbaum, you have a prepared statement which under the rule will be received in full in the record, and we will be pleased now to have you read it or present it in any way you wish.

STATEMENT OF HON. MURRAY L. WEIDENBAUM, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Mr. WEIDENBAUM. I thank you, Mr. Chairman, for those challenging remarks and for the opportunity to respond. It is always a pleasure to appear before you and this distinguished committee.

I have been asked in my invitation to address the problem of high interest rates and their impact on small business, and I certainly will do that too. As you know, the health of small business is a central concern to this administration.

I would like to summarize my prepared statement if I may, in the interest of time. I would just point out that small business accounts for the lion's share of new jobs, and this is a key reason for our concern with small business, and quite clearly until recently, the high and rising interest rates were a real source of difficulty. But I should like to note that short-term rates have recently registered some impressive declines from their early summer high, and I think that given the great concern about interest rates, it is worthy to note that just since the beginning of September, we have seen two declines in the prime rate from 20½ to 19½.

We have seen the sensitive Federal funds rate decline from 17½ to a shade over 15. We have seen the commercial paper rate decline from 17 percent to 15¼ percent. We have seen the Treasury bill rate decline from over 15½ to less than 14¼ percent.

We have a long ways to go to be sure, which is precisely why the President announced another round of budget cuts, but I think we should not overlook the significant progress that has been made to date in bringing down those painfully high interest rates which we inherited. And surely we are fully aware of the strains and stresses which high interest rates place on the entire economy, which is precisely why we are determined to reduce and ultimately eliminate that deficit spending.

But as usual there are two sides to the coin, and I just call to your attention that these high rates represent a serious cost to borrowers, but there are more savers than borrowers in our economy and those rates have substantially increased the income of millions of average-income Americans. Personal interest income is running 20 percent higher than a year ago. It constitutes nearly 13 percent of total personal income. For our senior citizens, taxpayers over 65, interest income accounts for over one-fifth of adjusted gross income.

Let me point out, Mr. Chairman, I have received considerable correspondence on the subject of high interest rates, but not a single senior citizen has written in to complain that they were getting too high a rate of interest on their hard-earned savings. If anything, that has been a source of welcome relief.

For the first time in decades, the average citizen has gotten a competitive market rate of return on his or her savings; however, the policies of this administration should be clear. We have embarked upon and we are maintaining a set of policies designed to bring about low, not high, interest rates. The combination of monetary restraint and reductions in spending is designed to bring about lasting reduction in inflation, and an end to deficit, and thus a permanently lower level of interest rates.

The administration's program is focused on the deep-seated and long-run programs affecting the American economy. Our program is a long-term one and thus has two important distinguishing characteristics. First, we have a deep skepticism of the stop-and-go policies, including some of those that have been urged on us this morning.

We believe that the only way to cure the inflation which has driven up the high interest rates is a sustained policy of monetary and fiscal restaint. The tax and budget programs recently enacted into law, along with our commitment to a stable, noninflationary monetary policy, in our views, are necessary and major steps forward in overcoming the serious problems now facing the American economy.

The economic pain we are experiencing today, we need to recognize, is the lagged rest of past mistakes. As this administration's policies take place, and I have to put it quite that way, because, as you know, October 1 is the date that the personal tax cuts begin, the initial modest 5-percent reduction is effective on October 1, the larger 10 percent across-the-board tax cut will be effective next July 1. But as those policies take effect and confidence in our economy is restored, our current problems will shrink, restoring the prospect of noninflationary growth which, of course, is our joint objective.

Let me take a moment, if I may, Mr. Chairman, to respond to your specific inquiries this morning.

Yes, the pressures on the deficit were higher than shown in the midyear review we released July 15, which is precisely why the President responded as he did last night. One of those pressures, one of them is right here on this side of Capitol Hill or this side of Pennsylvania Avenue, and that is the fact that Congress went a long way in cutting the budget and responding to the President's proposals but not all the way.

I cite the Congressional Budget Office. Its recent reports show a $15 billion shortfall, in terms of the cuts in the budget in fiscal 1982 needed to meet the President's proposal and, of course, you will note last night the President recommended $16 billion in additional budget cuts and revenue enhancement, a change needed primarily to overcome the shortfall in Congress prior action on the budget.

About the social safety net, let me assure you, Mr. Chairman, the programs in the social safety net will continue to get a rising share of the budget in this administration. I share your concern for eliminating waste, fraud, and abuse in military and civilian programs. As you know, we have translated that concern from rhetoric to action. We have a Council on Efficiency in Government which has reported a variety of serious concerns, specifics, and the actions taken to root out specific instances of, yes, waste, fraud, and abuse.

But let me deal as quickly as I can with your concern about those "brutal cuts," that is in quotes, of course, in some of the social programs. I think we need to distinguish between a compassionate heart and a clear mind. In terms of the school lunch program, I was amazed to find that unwittingly I was being subsidized all the years that my children were in the public schools. And if you had children in public schools you also were the recipient, Mr. Chairman, of a taxpayer's subsidy. And that is, every child, in eating the school lunch in the public schools, received a subsidy no matter how wealthy their parents are. Let me assure you, as a college professor, I wasn't quite in the mil-

lionaire category, but I was well able to afford to pay the full cost of my children's school lunches, and I do think it is wasteful to label as a needed social program subsidies to middle income and, yes, even to the top income taxpayers.

Now it is that kind of change that I can strongly concur with, and it is precisely that kind of change that we have made. But that social safety net will continue to get a rising share of the budget for people who are truly in low-income categories, who truly require the assistance.

You talked about the Defense budget. Mr. Chairman, I need to distinguish between the reality in the previous administration of very limited increases in the Defense budgets and the lame duck budget bequeathed to us as the administration left office. After the November election there was a sudden burst of generosity in the estimates last January. It reminds me of the gentleman who left a very generous will for his offspring, leaving them each $1 million in his will but no money in the bank to pay for it.

I think you should compare the actuality of our military budget estimates with the actuality of the military budgets under the previous administration. You will see in a very noticeable way, this administration has increased the military strength, certainly the military expenditures, in a measured way, to be sure, but in a visible way over the previous administration, even after those necessary cuts in military that the President did announce.

But in terms of focusing on the cuts that we have, that the President announced last night, let me correct any misimpression. They were across the board. There was a 12-percent cut in all discretionary programs. No program was targeted. No program was omitted. Every discretionary civilian program is subject to the same 12-percent reduction. It is across the board. In fact, I would urge the Congress to consider that sort of approach in its own budget. You might find it useful to exercise a 12-percent restraint on Congress budget.

Let me say that the Council of Economic Advisers has accepted the 12 percent in its budget on the very old but true basis, "What is sauce for the goose is sauce for the gander."

But in terms of the chairman's concern about poor people, which we share strongly, we have tried to learn from the mistakes of the past. We believe that we have, in effect, launched the largest and we think the most effective antipoverty program in modern times, a program designed to develop between now and 1986, 12 million new jobs, not make-work jobs supported by the taxpayer, but productive jobs in the private sector, and we think that is truly the most effective approach to dealing with the problems of low income and of poverty.

But in terms of taxes, there is no question in my mind that the desires of the American people are for lower taxes not higher taxes, and we have followed their wishes, but again, like the expenditure restraint, those tax cuts are across the board. The 5-percent tax cut effective October 1 will reduce taxes across the board. It is a 5-percent reduction in tax rates at every income level.

I thank you for the opportunity of being here, Mr. Chairman, Senator Sarbanes, and would welcome your questions.

Representative REUSS. Thank you very much.

[The prepared statement of Mr. Weidenbaum follows:]

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Prepared Statement of Hon. Murray L. Weidenbaum

Thank you for inviting me to appear before the Committee to address the problem of high interest rates and their impact on small business. As you know the health of small businesses is a central concern to this Administration. Over the past 10 years, they have accounted for the lion's share of the new jobs created by the economy, and we expect them to play a leading if not central role in producing sound economic growth in the eighties.

At the present time, we are experiencing weak performance in such key areas as automobiles, homebuilding, commercial construction and their supplier industries. Small businesses are heavily represented in these industries, particularly among construction firms and auto suppliers.

Contributing to the problems of businesses of all sizes has been the failure, until recently, of interest rates to decline from record high levels. Short-term rates have recently registered some impressive declines from their early summer highs, although long rates are still in the vicinity of their record levels.

We are fully aware of the strains and stresses which high interest rates place on the entire economy. To begin with, given the Federal Government's own borrowing requirements, outlays for interest expense have been running significantly higher than estimated originally. Moreover, we are very sensitive to the impact which high rates have had on small businesses, given their dependence on external financing.

Having said this I believe it important to point out that, on balance, the economy has held up extremely well in the face of these high rates. Since the beginning of the year, total civilian employment has risen by well over one million persons while personal income growth has been quite satisfactory.

It also may be relevant to point out that while these high rates represent a serious cost to borrowers, they have substantially increased the income of millions of Americans. Thus, it is not surprising that personal interest income is running some 20 percent higher than a year ago and that it now constitutes nearly 13 percent of total personal income. When you consider the fact that interest income accounts for over one fifth of adjusted gross income for all taxpayers over 65, you can appreciate the importance of this development.

It should be clear, however, that the economic policies of the Administration are designed to bring about low, not high, interest rates. The combination of monetary restraint and reductions in Federal Government spending is designed to bring about a lasting reduction in inflation and an end to large deficits and thus a permanently lower level of interest rates.

Although we have made a moderate degree of progress so far in bringing down the rate of inflation, I believe there are still many skeptical participants in financial markets who anticipate a weakening of our resolve to get inflation

under control. Consequently, their expectations of future inflation are still relatively large and reflected in interest rate inflation premiums.

Therefore, in order to bring down interest rates, it is essential that we convince these doubting Thomases that we are committed to policies of monetary and fiscal restraint and that we will not deviate from our long-term commitment to end inflation in order to pursue transient economic goals. Abandonment of these policies even temporarily would be a grave error. Financial markets would interpret any such move as a surrender to inflation and rates would soar, as they did in the fall of 1980.

In a sense, the current unsettled state of financial markets is one of the withdrawal symptoms of removing inflation and excessive borrowing as part of the American way of life. Having grown accustomed to inflation, all of us -- government, business, farmers and consumers -- borrowed more and more, all too often intending to repay that debt with cheaper dollars or with inflation-swollen tax receipts and capital gains. As inflation recedes and price increases in a wide array of products and services become smaller and smaller, there will be a growing realization that inflated capital gains on land and real estate are not what they

used to be, and can no longer justify the present level of interest rates.

At the moment, however, too many sectors of the economy are still excessively hooked on borrowing, beginning with the Federal Government. The major provisions of the recently passed tax legislation, particularly the across-the-board reductions in individual tax rates and Congress' inclusion of indexing personal tax rates, make it clear that further tax rate increases will not be available to fuel the Federal Government's spending habits. Only substantial additional budget reductions, consistent with the appropriate role of the Federal Government in American life, can remove the danger of "crowding out" the private sector's legitimate borrowing needs. Thus only by reducing the Federal Government's demand on private saving can we insure that the funds will be available to finance the strong private sector growth we anticipate in 1982 and beyond.

The Administration's program is focused on the deep-seated and long-run problems affecting the American economy. Thus our program is a long-term one and has two important and distinguishing characteristics. First, we have a deep skepticism of the traditional stop-and-go policies of the past, whose transitory benefits only helped create the longer run problems, such as the stagflation and high interest rates, which faced this Administration when we came into office. Once the public develops confidence that we have truly repudiated the inflationary policies of the past, interest rates will decline and stay down.

The other central characteristic of our program is based on the primacy of the private sector in the American economy. We have an inherent, philosophical preference for private activity. We also recognize that the most effective way to provide productive jobs and an environment where individual initiative and risk-taking can flourish is one in which the Federal Government plays a substantially lesser role than it has in recent years. Reducing the reporting and regulatory burden on business in areas where such requirements are not cost effective will be a substantial boon to small businesses which suffer disproportionately from this type of government behavior. In addition, the recent cuts in income, capital gains, and inheritance taxes along with the liberalization of depreciation allowances will also contribute to the health of smaller enterprises who will now be able to keep a higher percentage of their income and therefore be less dependent on external financing.

In conclusion, the tax and budget programs recently enacted into law along with our commitment to a stable non-inflationary monetary policy are necessary and major steps forward in overcoming the problems now facing all sectors of the American economy. The economic pain we are experiencing today is the lagged result of past policy mistakes. As this Administration's policies take effect and confidence in our economy is restored, our current problems will shrink, restoring the prospect of non-inflationary growth that will benefit all.

Representative REUSS. Mr. Weidenbaum, last February 24 when the President's program was placed before the Congress, you testified before the Committee on Ways and Means as follows, and I'm quoting from you:

> If each of the four elements of the President's program: tax cuts, budget cuts, regulatory reform and tight money, is carried out swiftly, a decline in inflationary expectations will be quickly translated into lower interest rates and rising value of financial securities.

Is that still your view?

Mr. WEIDENBAUM. Yes.

Representative REUSS. I admire your dauntless spirit, but how do you account for the fact that Congress did what you asked Congress to do?

Mr. WEIDENBAUM. Not quite.

Representative REUSS. And if you're now showing signs of ingratitude after all of the champagne toasting that went on in the White House after we passed the wrong-headed budget bill and the ill-conceived tax cut, that would be uncharacteristically churlish of you.

Mr. WEIDENBAUM. Not being there to sup on the champagne, forgive me. Not having engaged in those festivities, I take a more low-keyed view. First of all, the Congress did enact a very substantial and bipartisan reduction in the budget and that is commendable, and that is unparalleled. But you didn't go all the way. After all, as the congressional budget has pointed out, you were $15 billion shy of going all the way.

Second, promptness. Let's note that my statement was based on the assumption that the tax cuts would be effective July 1. As a result of the legislative process, they will not be effective until this coming October 1.

But in terms of the decline in interest rates, as I just pointed out, since September 1, we have had a decline, a significant decline in interest rates, so I have no difficulty with my statement.

Representative REUSS. We will accept your statement that you weren't in on the champagne drinking, but did you take the stump and go to the media in July and August to dissociate yourself from the administration and to cry:

> Shame! Congress hasn't done what the President asked on the budget and taxes and hence it isn't going to work. And I herewith withdraw, that all may know, my proud prediction of February 24 that the Dow Jones was going to head up and interest rates were going to head down, if this were to come to pass?

Mr. WEIDENBAUM. I respect the chairman's capability to forecast, but to pass judgment upon a program that hasn't yet fully gotten underway, I would suggest is a bit premature to make a forecast as to whether the program that in good measure takes effect October 1, many parts of which won't take effect until January 1 or next July 1—to make a forecast as to whether it will work or not, is obviously within your professional competence or mine, but to make a judgment whether it has already worker, I suggest is premature.

Representative REUSS. Well, next Thursday is October 1. Do you want to come back here then and see if the President's program has been, in your phrase, "quickly translated into lower interest rates and rising value of financial securities"?

Mr. WEIDENBAUM. Lower interest rates. I submit that the two cuts in the prime rate this month are welcome indications of lower interest rates. They are the reality.

Representative REUSS. In fact, long-term interest rates have gone and continue to go up since the President's program got enacted—mortgage, corporate AAA bonds, and municipal bonds.

Mr. WEIDENBAUM. Ten-year Treasuries are down a modest 20 basis points since the beginning of the month. Corporate AAA's are down again a modest number of basis points.

Representative REUSS. They are up since August 3 when the program was passed, by a very substantial amount, are they not?

Mr. WEIDENBAUM. My table starts on December 1. No doubt, the chairman is accurate. But seriously, the expectation——

Representative REUSS. My table, furnished by the Federal Reserve, shows that——

Mr. WEIDENBAUM [continuing]. The expectation that a program that is barely underway is to have instantaneous results, I think is excessively optimistic. It certainly wasn't my point. If you are truly concerned, as I am, about long-term rates, I suggest financial markets need reassurance from the Congress that the budget will be effectively controlled. I think if you share our concern about getting those rates down, especially long-term rates, you will support warmly the President's proposals of last night.

Representative REUSS. Just on the question of what happened to bond rates, here is the Federal Reserve figures: Corporate AAA bonds, August 12, 15.54 percent; August 15, 15.59 percent; August 26, 15.98 percent; September 2, 16.11 percent; currently, 16.32 percent. They have been going up steadily, and the same is true of municipals. But not to quibble, because you did agree that, by and large, interest rates are outrageously high and must come down. Short term, long term, intermediate term, and everything else.

Mr. WEIDENBAUM. Yes, and the chairman's arithmetic is impeccable.

Representative REUSS. So we won't have to spend too much time on that. The President last night asked for the elimination of some of the Treasury guaranteeing authority, back-door guaranteeing, whatever it is called, what was it, $10 billion worth?

Mr. WEIDENBAUM. $20 billion worth.

Representative REUSS. $20 billion. And I, for one, intend to look carefully at that, because depending upon the nature of the program, if it isn't necessary, we should cut down on Treasury guarantees, just as we should cut down on anything else. However, the administration and the Federal Reserve remains wholly opposed to the kind of credit conservation which this committee has been calling for for a long time. This committee thinks it is outrageous that commodity speculators like Bunker Hunt currently are into the banks for one entity, more than $1 billion.

This committee thinks it is outrageous that the major banks currently are making $25 billion available for just a few of the hundreds of corporate takeovers that are going on. Yet, when we suggest that the administration, by simply urging the banks to cut down on inflationary credit so that it would have more available for inflation-fighting credit, when that suggestion is made the administration waves it aside as credit allocation and other things it doesn't like.

Why does it get so excited about Treasury lending for a loan guarantee, and yet swallows without protest the diversion of so much of our scarce national credit? The commodity speculation, corporate takeovers and other unessential purposes. I don't get it.

Mr. WEIDENBAUM. I will be glad to explain. First of all, there is only one place that is worse in terms of the allocation of credit than our private commercial banking system and that is the Federal Government. The political allocation of credit, measurably, visibly, is far more inefficient and far less effective, and just look at the array of those credit programs that the President talked about, those loan guarantees. Look at the hodgepodge that Congress, through the political process, has established over the years. I suggest the allocation of credit, albeit imperfect, through the commercial banking system is far more effective.

Representative REUSS. You act, though, as if the proposition put to you and the administration was that the Federal Government should get in the business of supervising each and every bank loan. Not at all. Nobody suggested that. But why are you opposed to President Reagan speaking out to say the banking community, and urging them within their sound discretion, to please cut down on the zeal with which the make merger takeover loans and commodity speculation loans, so that they can have a little more left to make the kind of inflation-fighting productivity enhancing loans which they ought to be making. What is wrong with that?

Mr. WEIDENBAUM. That type of jawboning, we have learned the hard way, is not terribly effective. It also deflects attention from the serious problems—why is capital attracted to those ventures? And that is because of the low real yield, the low real return on what you and I may consider to be more productive ventures.

This is precisely why we urged and the Congress adopted a tax bill that increases the reward for saving and investment, especially productive investment, that is, the 10–5–3. Liberalization of depreciation allowances for physical asset investment. There is no 10–5–3 for corporate takeovers.

Representative REUSS. What you have just said is, of course, typical of the rich man oriented approach of this administration. Not only did you force through a tax bill which gives untold bonanzas to the wealthiest 5 percent of the population. You are suggesting that nobody should even raise a breath against the banks seeking out terribly inflationary loans for commodity speculators and corporate takeover artists, just because they can make a nickel more on it. That really is the big issue between you and your administration and the Democrats of this committee, and I think that is part of the dialog which the President asked for last night. And you are going to get quite a bit of it.

Mr. WEIDENBAUM. I always hesitate to correct the chairman, but when you use the term "rich man's tax bill," that isn't quite in accord with the facts. There are unique provisions in this recently enacted tax law for small business. I will be glad to submit for the record, if you would like, a long tabulation of the special provisions benefiting small business in the tax bill above and beyond the general provisions benefiting all business. For example——

Representative REUSS. Well, that will be good if you will submit that.

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[The following table was subsequently supplied for the record:]

TAX REDUCTIONS FOR SMALL BUSINESS IN THE ECONOMIC RECOVERY TAX ACT OF 1981

[In billions of dollars]

	Fiscal year—				
	1982	1983	1984	1985	1986
Estate and gift tax provisions	−0.2	−2.1	−3.2	−4.2	−5.6
Increase Keogh plan limit to $15,000 (Jan. 1, 1982)	(1)	−.2	−.2	−.2	−.2
Phased-in expensing of assets: $5,000 in 1982 increasing to $10,000 by 1986.	−.5	−1.0	−.9	−.8	−.3
Small business corporate tax rate reduction (Jan. 1, 1982)	−.1	−.3	−.4	−.5	−.5
Increase used property limit for the investment tax credit to $125,000 for 1981–84 and $150,000 thereafter.	−.1	−.1	−.1	−.1	−.2
Increase accumulated earnings credit to $250,000 (Jan. 1, 1982) and liberalize subch. S rules.	(1)	−.1	−.1	−.1	−.1
$2,500 windfall profit tax credit for royalty owners for 1981, replaced by exemption of 2 bbl/day in 1982 through 1984 and 4 bbl/day in 1985 and thereafter	−1.2	−.8	−.9	−1.1	−1.1
Exempt stripper oil production by independent producers (Jan. 1, 1983)		−.3	−.4	−.4	−.4
Write-off of motor carrier operating rights	−.1	−.1	−.1	−.1	(1)
Stock options	(1)	(1)	(1)	(1)	(1)
LIFO inventory simplification	−.1	−.2	−.2	−.1	−.1
Total	−2.3	−5.2	−6.6	−7.8	−8.6

[1] Less than $50,000,000.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Aug. 3, 1981.

Representative REUSS. Meanwhile, is it not a fact that the tax bill signed by the President reduces the number of people who will pay any estate tax at all by many times?

Mr. WEIDENBAUM. That is right. People of middle income, middle wealth distributions, the owners of the family farm, the owners of the small business, will truly benefit so that——

Representative REUSS. Those, of course, were dragged out to kind of buzz over the fact that a nonfamily farmer and a nonsmall businessman with, say, $20 million at his death, gets, under the Reagan tax, the State Tax Reduction Act, $4 million. Now, that is not a little farmer.

Mr. WEIDENBAUM. When you say "gets,"——

Representative REUSS. Doesn't have to pay.

Mr. WEIDENBAUM. I appreciate the distinction. Your first point about being excluded from those State tax, those wealthy people are not excluded. Their estates are not excluded from the estate tax. The exclusions are those people of much more modest wealth. They are still subject to a steep tax. Basically, as a way of providing incentives for private saving and investment, the Government won't be taking quite as much out of private income and wealth as it has in the past. And I think again, this is what the American public wants.

Representative REUSS. Well, I'm sure that the $20 million type wants it. Whether the kid who is asked to accept ketchup as his vegetable on the school lunch wants it or not is something we will have to await.

Mr. WEIDENBAUM. That has been eliminated. That was a very low-level decision which the President has overruled.

Representative REUSS. Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Mr. Weidenbaum, I understand you have to leave fairly soon to go to a White House press conference.

Mr. WEIDENBAUM. Yes, sir.

Senator SARBANES. We may perhaps consider this hearing as a dry run for that.

Let me ask you one preliminary question. Do you ever eat in the White House mess?

Mr. WEIDENBAUM. Yes, sir.

Senator SARBANES. Well, I am staggered, then, that you should come here this morning and launch into that disquisition on the school lunch program and how shocked you were to discover that your own children's lunches were receiving at least a small subsidy, in view of the fact that you are participating in what is probably the most heavily subsidized eating program in the country, with the exception perhaps of some in the wealthiest corporate board rooms. Isn't that correct? Isn't that White House mess incredibly underwritten by the taxpayer?

Mr. WEIDENBAUM. Senator, I will be glad to tell you which direction the subsidy goes. If every program took the cut in income that the Chairman of the Council of Economic Advisers has taken in order to serve in this position, you wouldn't have to worry about balancing the budget, sir. You would have such a large surplus you could declare dividends.

Senator SARBANES. I don't understand that point. Is it that you took such a cut to come into the Government that you are entitled to the subsidized lunch?

Mr. WEIDENBAUM. I am saying I am not receiving any subsidy.

Senator SARBANES. At the White House mess?

Mr. WEIDENBAUM. I say, sir ——

Senator SARBANES. I would not have made that point had you not brought up the subject with respect to the school lunch program.

Mr. WEIDENBAUM. I have no financial report on the White House mess or on any of the other eating facilities at either end of Pennsylvania Avenue.

Senator SARBANES. There was a long story in the press not long ago about the extent to which those meals are being subsidized. For you to sit there, only a few minutes ago, and demonstrate about the school lunch program, is incredible. The fact is that the underlying subsidy is what makes the hot meal program possible at all. And of course, if we're going to be able to provide it for poor children, we have to be able to have a school lunch program in place.

The Senators from the rural areas of the country are extremely concerned that there will be no more hot school lunch program in their areas as a consequence of the cuts being made in the school lunch program. Now, one can argue about that but I don't think you ought to come in here and express indignation over your children's case when you in turn enjoying the heavily subsidized White House mess meals.

As I understand your ——

Mr. WEIDENBAUM. I rarely eat there.

Senator SARBANES. As I understand your point, it is that you need time for the program to get into place; is that correct? Is that an essential premise of the administration's position on their economic program?

Mr. WEIDENBAUM. It is just a commonplace observation that changes in economic policy don't work their way through this complex economy instantaneously.

Senator SARBANES. Well, then how long do you expect those sectors of the economy affected by extraordinarily high interest rates, which have provoked a virtual recession, if not depression, to have to withstand them?

Mr. WEIDENBAUM. I share, and my administration shares the Senator's concern about high interest rates. This is precisely why the President announced the large budget cuts last night.

Senator SARBANES. I understand that, but you haven't put the pieces together in the timeframe—a timeframe that offers any hope. Why shouldn't there be, as part of a comprehensive program, a monetary policy taking effect promptly to enable the sectors of the economy that are about to go under to function.

Mr. WEIDENBAUM. The monetary policy that is in place, in my understanding, is a restrained growth in the supply of money and credit.

Senator SARBANES. Do you support the policy that the Federal Reserve is now pursuing?

Mr. WEIDENBAUM. I think that the Federal Reserve is pursuing an appropriate policy; that the monetary targets that they established are appropriate.

Senator SARBANES. Well, they are not even reaching their monetary targets. What is your position on that?

Mr. WEIDENBAUM. It really depends, Senator, on which of those targets you look at. If you look at M_2, they are at the top end of the range. If you look at M_{1B}, they are in the last few months below the range.

Senator SARBANES. Well, do you think that they should alter the latter category at least?

Mr. WEIDENBAUM. That, of course, is a matter of judgment.

Senator SARBANES. What is your judgment?

Mr. WEIDENBAUM. It is my expectation that by and large, the Federal Reserve will, and it is certainly doing its best to effectuate a growth in the money supply within their tragets.

Senator SARBANES. Are you critical of the Federal Reserve and the posture it is taking?

Mr. WEIDENBAUM. On the contrary, I have been very supportive of their basic stance of monetary restraint consistent with the very real fact that the Fed is independent of the executive branch and it should continue to be so.

Senator SARBANES. How does the high interest rate policy square with your efforts to lower the deficit, when your own budget people have indicated that one of the reasons you are confronting a larger deficit problem is the significant increase in the carrying charge on the existing Federal debt; and that second, another reason you are confronting an increasing deficit problem is that high interest rates are provoking a recession in certain sectors of the economy, which means that people are being laid off and thrown out of work and therefore ceasing to pay taxes and instead drawing support payments from the Treasury. Isn't it working at counterpurposes with that you seek to accomplish?

Mr. WEIDENBAUM. Those high interest rates are a problem. They are not our policy. Our policy is to get those interest rates down. The serious question is how do you do that?

Senator SARBANES. When do you anticipate that the interest rates will come down to some range in which small business and home-builders and auto dealers and people in comparable sectors will be able to function on anything other than a desperate survival basis?

Mr. WEIDENBAUM. Sir, they will come down sooner, to the extent that Congress signals to the financial markets its strong support of budget cuts and deficit reductions.

Senator SARBANES. Well, now, the Congress did that, Mr. Weidenbaum. Major cuts were made. The promises you held out—the chairman read your statement from last February, the 24th—didn't materialize. Now, shouldn't monetary policy be fitted into place concurrently with the rest of your policies?

What you are saying to certain sectors of the economy which are virtually flat on their back is, in the by and by, that maybe something is going to happen. By that time, a number of extraordinarily efficient and long-standing economic enterprises will have simply disappeared from our society.

Mr. WEIDENBAUM. Before you joined the hearing, Senator, I pointed out the progress that had been made in reducing interest rates to date. But let me call attention to the chart that the committee has here. It is a bit mislabeled, to be sure, because this really is the before. There is an old song about being the before that is before the after. Well, you can appreciate that this is the before. This chart ends in December, before the October 1 tax cuts and budget cuts take effect.

Now, the House Budget Committee on Monday, had the companion chart, the after. And that is the forecast of interest rates, not just the administration's but the forecast of interest rates under the Reagan program in the years ahead by the Congressional Budget Office, by the Wharton School, by Data Resources. And the fascinating part of that chart showing the results, that truly interest rates under the Reagan program was the downward movement under all of those forecasts.

Representative REUSS. Now I know why Mrs. Rivlin's name was mentioned with such passionate enthusiasm in the President's speech last night.

Senator SARBANES. What do you expect interest rates to be at the end of this year?

Mr. WEIDENBAUM. I don't have a pinpoint forecast. I expect them to be lower. I expect the reduction in interest rates that we have seen through the first 3 weeks of September to continue. Of course, not in a straight line, but that the trend will be downward and I think that trend will be accelerated by the evidence of the determination of the Congress and the administration to continue the program of budget restraint which is the basic way of getting those deficits down.

Senator SARBANES. Are you considering the reduction of the prime rate from 20½ to 20 percent as an incredibly significant breakthrough?

Mr. WEIDENBAUM. I consider the movement of the prime from 20½ to 20 to 19½ percent as a move in the right direction.

Senator SARBANES. That wasn't the question. The question was whether you regard it as a significant breakthrough?

Mr. WEIDENBAUM. I wouldn't use those—that is a bit more of a vivid description than I would use, Senator.

Senator SARBANES. Now, I am little concerned——

Mr. WEIDENBAUM. I am concerned about those high interest rates.

Senator SARBANES. That's the next point I wanted to get to. I wanted to find out just how concerned you are, my question is prompted by a paragraph in your prepared statement, which given the seriousness of the problem, I really find of extraordinary concern. And let me just read a couple of sentences of it:

> It also may be relevant to point out that while these high rates represent a serious cost to borrowers, they have substantially increased the income of millions of Americans.

And then you go on to talk about how interest income has significantly increased in percentage terms, and so forth. And of course, that is quite true.

Am I to draw from your prepared statement that your deep concern about the high interest rates is tempered or ameliorated by the fact that on the other side of the ledger they do, indeed, as you say, represent a substantial increase in the income of millions of Americans? I would point out, by and large, Americans in the affluent category to which the chairman was referring earlier. At any rate, are we to take the fact that a paragraph of that sort is even included in the statement as indicating an offsetting or softening of your concern about the high interest rates?

Mr. WEIDENBAUM. No, sir. It is the professor in me who reports on the phenomenon, warts and all. But I call your attention to the very next paragraph where I say it should be clear, however, that the economic policies of the administration are designed to bring about low, which is underscored, not high interest rates.

Senator SARBANES. Now if the high interest rates continue to prompt a recession in certain sectors, slowing economic activity, throwing people out of work, so that they cease to pay taxes into the Treasury and start drawing payments out of the Treasury, the deficit will certainly increase. Aren't you into a vicious circle where you are then constantly trying to address the deficit by further tightening measures, which only drive you into a further downward spiral? At what point are you going to put into place, or will we have into place, a balanced policy, particularly in the interest rate sector, that enables interest sensitive sectors of our economy to function with anything approaching normal circumstances?

You don't contend today that they can do that in autos or housing or small businesses, do you?

Mr. WEIDENBAUM. I suggest we may have a different view as to how to bring interest rates down. I will say how not to bring them down, and that is an easy money policy that fuels the inflation, which drives up the interest rates further.

Senator SARBANES. Let's start with the first point. Would you regard the Federal Reserve's meeting the monetary targets which it has established instead of falling short of them, as an easy money policy?

Mr. WEIDENBAUM. No, sir.

Senator SARBANES. Do you think the Fed should do that?

Mr. WEIDENBAUM. There's no question in my mind that those are the appropriate targets.

Senator SARBANES. Do you think the Fed should meet those appropriate targets?

Mr. WEIDENBAUM. You present targets surely for the purpose of meeting them.

Senator SARBANES. Well, they are not doing it in some instances. Do you think they should do so?

Mr. WEIDENBAUM. Now, it is impossible, to my knowledge, to put monetary policy on an automatic pilot, so earlier this year M_{1B} was above the target.

Senator SARBANES. Mr. Weidenbaum, I'm giving you an opportunity this morning for the administration to send a signal to the Federal Reserve. Not a signal that it ought to open the flood gates—we are far short of talking about anything of that sort. To suggest that is simply to put a scarecrow out there in the field.

I'm giving you an opportunity right now to send the Federal Reserve a signal that says, at least at a minimum, that the Fed ought to be meeting its own established monetary targets, which at the moment, in certain instances, it is falling short of doing.

Do you want to send them that signal?

Mr. WEIDENBAUM. I appreciate the opportunity, but I have no shortage of opportunities to provide my views to the chairman of the Fed, as I had an hour session with him prior to coming here this morning.

What I would like to do——

Senator SARBANES. What did you tell him?

Mr. WEIDENBAUM. We, as is our custom——

Senator SARBANES. Let us in on the secret. This is an important issue.

Mr. WEIDENBAUM. I wouldn't want to bore you with the details. [Laughter.]

Senator SARBANES. We're quite prepared to be bored.

Representative REUSS. You're never boring. Just tell us. [Laughter.]

Mr. WEIDENBAUM. The chairman inquired as to the nature of the cuts proposed by the President last night, and I gave him our detailed backup, which we are releasing to the press, citing the details of the $16 billion of expenditure cuts and revenue enhancement. He welcomed this information, but—I will let him, of course, speak for himself, but on many occasions our expression of support for monetary restraint has been met by expressions from the Federal Reserve of support for budget restraint.

Senator SARBANES. Let me ask you this question. You are a distinguished economist. If the economy were to go into a recession, into a downturn, what would the implications of that be with respect to your efforts and the efforts of the Congress to try to reach a balanced budget?

Mr. WEIDENBAUM. In terms of the ability to attain a balanced budget in 1984, which is our target, I am not aware that that hypothetical situation would alter that achievement. It might, very frankly, alter the path of revenues and expenditures, and hence of the deficit during the period. You might make less progress during a recession and more progress during a period of—as is typical, of rapid growth as you pull out of a recession.

Senator SARBANES. Well, wouldn't a recession, in and of itself, make it more difficult to move toward balanced budgets since you would have a slowdown in economic activity and therefore a drop in revenues?

Mr. WEIDENBAUM. Not in my view, because our policy is not a cyclical policy but, as you said from the outset, oriented for the long run.

Senator SARBANES. Well, are you indifferent as to whether we have a recession or not?

Mr. WEIDENBAUM. No, sir. I am concerned about the effects of rising unemployment, which is precisely why we have emphasized the need for tax cuts and regulatory relief to provide incentives and financial support for a healthier, stronger rate of economic growth.

Senator SARBANES. Well, of course you don't want a recession.

Do you have any comment on the story in today's New York Times that in the latest survey of business economists that 53 percent of them expect us to be into a recession by the end of the year, compared to only 25 percent at the time of the previous survey?

Mr. WEIDENBAUM. Let me add to that, because I spoke, at their request, to the National Association of Business Economists at their annual meeting, and I had a very spirited question and answer session. Almost every question they asked me related not to the GNP but to budget cuts, to deficits, to the progress that we are making in dealing with that basic factor. And some of them expressed some skepticism of the degree of support that we might get—that the administration might get here on Capitol Hill for additional budget cuts, for additional progress on getting the deficit underway. And I take that as a challenge to economic education.

Senator SARBANES. In coming forward with the latest proposals, do you consider recouping of some of the tax concessions contained in the last tax bill—for example, the billions in additional tax concessions given to the oil companies?

Mr. WEIDENBAUM. There is $3 billion of what is termed "revenue enhancement" in the President's $16 billion package, which will be spelled out subsequently. But very frankly, I will not defend each and every provision in that tax bill.

On balance, I think it was and is a very good bill, a useful addition to public policy.

Senator SARBANES. Just looking at it from an academic perspective, obviously one of the options available to you would have been, instead of cutting more deeply into some programs as you have proposed, programs which may be wise investments in the future, to recover some of those recent tax concessions which upon examination do not seem to be very wise, from the point of view of encouraging productivity? I don't see what it is that you're hoping to get out of further tax breaks to the oil companies.

Mr. WEIDENBAUM. I think you have to look—and, sir, that has been our experience over decades—in both Democratic and Republican administrations. You look at a large comprehensive tax bill as a package.

As you know, we sent up to Capitol Hill a very clean tax bill. And it was in the legislative process, the normal give and take of the legislative process, on both sides of the aisle, in which those special provisions were added.

Senator SARBANES. But with very strong support from the administration.

Let me ask you a question on the credit conservation point which the Chairman was addressing. And no one is talking here about the Government undertaking any credit allocation program or anything of that sort.

Let me ask you this question. In your conversation with Chairman Volcker, did you indicate to him that you thought the Fed perhaps ought to indicate to the banking system, given the tightness of the credit situation, that lenders ought to take a more negative attitude toward financing corporate takeovers or commodity speculation, or similar activities, and that the Fed ought to urge the financial institutions to try to direct their resources more toward more productive investments in the economy?

Mr. WEIDENBAUM. Frankly, that is not a recommendation I would make in public or in private. I would think it is counterproductive.

Senator SARBANES. Why?

Mr. WEIDENBAUM. I think that opens the door for Government control of credit.

And as I said to the Chairman in response to a similar question, whatever the imperfections are of the private commercial banking system, when I look at the imperfections of Government credit allocation and you look at that array of Government credit programs——

Senator SARBANES. We're not talking about Government allocation of credits, Mr. Weidenbaum. What concerns me is that while you're taking this hands-off, let-it-all-work-out policy, important sectors of our economy are simply going under.

You may think it all sounds fine and good, but the small businessman who is confronting the situation, who has been in business 20 or 30 years, or the farmer or the homebuilder, are just going under.

Mr. WEIDENBAUM. We are very well aware of the difficulties being faced by those important sectors of our economy. We are concerned with developing effective solutions.

Senator SARBANES. Thank you, Mr. Chairman.

Representative REUSS. Mr. Weidenbaum, the President had some things to say last night about social security. And he called for a bipartisan solution to the problem. And he then spelled it out in detail. He suggested that the matter be left to a 15-person commission, of which 5 members would be appointed by himself, 5 members by the Republican majority leader of the Senate, and 5 members by Speaker O'Neill of the House; that would mean, if my arithmetic is correct, 10 Republican appointees and 5 by the Democrats.

Does that seem to be a fair way of getting a bipartisan solution?

Mr. WEIDENBAUM. It is our understanding that the selections would be bipartisan. So there is nothing in the President's statement that would indicate anything to the contrary. Therefore, I would frankly hope that Speaker O'Neill would nominate and appoint five people from a variety of parties and that Senator Baker would do the same, and that the President I anticipate would do the same.

Representative REUSS. Well, I'm not following you. It is still ten people appointed by Republican officials and five people appointed by Democratic.

Mr. WEIDENBAUM. Yes. But the results wouldn't necessarily mean 10 Republicans versus 5 Democrats.

Representative REUSS. I didn't say that. I am talking about the appointing authority, which is quite important.

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And I renew my question: Do you think that is fair?

Mr. WEIDENBAUM. Yes, because it reflects the decision of the voters in the composition of the executive branch, the Senate, and the House. There have been periods in the past where the House leadership appointed members of a Commission, and the Senate leadership appointed members of a Commission. And both of those officials were Democrats. I assume that was satisfactory back then.

Representative REUSS. Well, I suspect that Speaker O'Neill will feel that this pate is a little heavy on the elephant and a little light on the donkey and will not regard it as a bipartisan solution.

Mr. WEIDENBAUM. We certainly view it as a bipartisan solution, and I urge the Congress—I know the President urges the Congress to take it in that spirit.

Senator SARBANES. Well, if that is the intention, why isn't the basic appointing authority on an equal basis then in order to accomplish the bipartisan objective?

Mr. WEIDENBAUM. You appreciate the difficulties of developing a Commission that is not too large, that is bipartisan, that represents both branches. And I think the President's recommendation for the 5–5–5 is a sensible balance of those different demands.

Representative REUSS. Well, I asked for your view, and I've gotten it.

On one other subject, the leading supply side expert, Representative Jack Kemp, has recently been saying that the reason the President's program of tax cuts, budget cuts, regulatory reform, and tight money—the four-point program is not succeeding is that apparently there was an undisclosed fifth part of the program which has not been enacted. And because we don't have it, that is why the program is such a flop.

Mr. Kemp refers to the gold standard and says that we won't have the lower interest rates and rising markets until we adopt the gold standard.

Do you feel that that is a valid position?

Mr. WEIDENBAUM. My distinguished friend from New York is quite capable to speak for himself.

Representative REUSS. I know he is, but I just wanted your view.

Mr. WEIDENBAUM. In terms of the administration's view, which is your question, Mr. Chairman, we have a four-point program. And it is precisely the four points that you and he mentioned.

In terms of the question on gold, you and I both have the honor of serving on the Gold Commission. I have told the President that I take—and this, as you know, is a commission set up under a statute passed by Congress last year—I take the assignment seriously; I go into the Commission's deliberations with an open mind. And he indicated that is precisely what he expects of me.

Representative REUSS. Thank you very much, Mr. Weidenbaum. You need now to return to your other duties. We appreciate, as always, your appearance here.

Mr. WEIDENBAUM. I thank you and Senator Sarbanes.

Representative REUSS. Senator Sarbanes, we will now be grateful if you could ask your panel of citizens of the State of Maryland to sit down at the table with you.

And you recently brought great credit on this committee by going out on the byways of Maryland, giving all sorts of citizens a chance to testify. And you have this morning brought a cross-section of those witnesses along with you, so that there would be spread on the full committee record here in Washington what high interest rates are doing to people in the State of Maryland. So, Senator Sarbanes, we welcome you and your constituents.

STATEMENT OF HON. PAUL S. SARBANES, A U.S. SENATOR FROM THE STATE OF MARYLAND

Senator SARBANES. Mr. Chairman, I will be very brief. I have a prepared statement covering in detail some of the work we did during the week of hearings. I would ask that that be included in full in the record.

Representative REUSS. Without objection, so ordered.

Senator SARBANES. Under the auspices of this committee, the Subcommittee on Investment, Jobs, and Prices conducted six hearings throughout the State of Maryland during the week of August 31 through September 4 to investigate the effect of today's high-interest-rate policy on local communities and local businesses in the State.

Mr. Chairman, we heard from 85 witnesses who represented major interests and sectors of the Maryland economy, including farmers, auto dealers, home builders, realtors, small businessmen and businesswomen, the administrators of some of our local financial institutions, particularly the savings and loans, and officials of the State government and of various local governments. I think those hearings were extraordinarily informative. And, of course, the transcript from them will be prepared for the benefit of Members of the Congress.

At every hearing witnesses described in detail the immediate practical consequences for their own communities, families, and businesses of the current unprecedented level of interest rates. And I think in every instance their testimony underscored the seriousness of the distortions and the urgency, the absolute urgency of the problems which high interest rates have created. Thank you.

[The prepared statement of Senator Sarbanes follows:]

Prepared Statement of Hon. Paul S. Sarbanes

Mr. Chairman, during the week of August 31 through September 4, the Subcommittee on Investment, Jobs and Prices of the Joint Economic Committee, under my chairmanship, conducted six hearings throughout the State of Maryland to investigate the effect of today's high interest rate policy on local communities and local businesses in the State. The Subcommittee heard from 85 witnesses who represented major interest-sensitive sectors of the Maryland economy, including farmers, auto dealers, homebuilders, realtors, small businessmen and women, administrators of some of our local financial institutions, and officials of the State government and of various local governments.

In my view, and I believe is the view of both those who participated in and those who attended the hearings, they were extraordinarily informative. At every hearing witnesses described in detail the immediate, practical consequences for their own communities, families and businesses of the current unprecedented level of interest rates. In every instance their testimony underscored the seriousness of the distortions and the urgency of the problems which high interest rates have created.

It is no exaggeration, Mr. Chairman, to say that the problems created by continuing high interest rates are approaching crisis proportions. The situation this year, with the prime rate remaining over 17.5 percent, is unparalleled. In the last 12 months, the prime rate has been as high as 21.5 percent. Today it is still 19½ percent. The

mortgage rate at many financial institutions is over 18 percent, the highest it has ever been. The interest rate on tax-free municipal bonds is now over 13 percent, twice what local governments had to pay only 2 years ago. These rates have created grave obstacles to the operations of many established and productive enterprises, particularly in those sectors of the economy which depend upon a line of credit. The damage thus far is extraordinarily severe and, if conditions are not soon improved, will be irreparable. Enterprises which have been important economic assets to their respective communities, important economic resources, will be lost.

In the six separate hearings conducted by the Subcommittee in Maryland, certain themes recurred concerning the severe challenge of high interest rates -- a challenge which the witnesses who testified know best since they face it daily in their own economic activities. I would like to summarize our findings for the full Joint Economic Committee.

First, the high interest rates, ostensibly designed to check inflation, themselves have become an important contributing factor to inflation. In housing, the availability of an assumable loan or some form of creative owner financing, which brings down the cost of financing a home, is almost always reflected in a higher price for that home. Farmers testified repeatedly that they have no choice but to pass on the high cost of credit to consumers in the form of higher prices. Small businessmen, homebuilders, auto dealers and others expressed the same views.

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The effect of high interest rates on housing prices is especially onerous because it shows up directly in the CPI. Virtually every realtor who testified confirmed the fact that homes with some form of owner financing or assumable loan at below market interest rates will sell at a premium over houses with no special financing. The reason is simple -- if an owner is providing financing at a deep discount from market rates, he will try to make up the money lost on the financing by charging a higher price for his home. And he knows he will get it, because the interest rate on financing often makes a critical difference to a family's ability to purchase a home. As one realtor pointed out, two identical houses next to each other could carry prices that are thousands of dollars apart, if one has special financing and the other does not.

High interest rates are also forcing up the price of new homes. Many builders, in the current market, will "buy down" the interest rate charged by a mortgage lender for one to three years in order to make it possible for potential buyers to qualify. For example, one builder testified that to buy down a loan from 17 percent to 14 percent on a $160,000 house would cost him almost $20,000 which he would have to pay the bank before receiving the loan commitment. As he pointed out, he must add this to the price of the home. Another builder testified that in 1979, the finance cost on a construction loan for $100,000 would come to $6,500. Today, at an interest rate of 17 percent, the total finance cost for a $100,000 house comes to $26,000, or a 400 percent increase. All this goes into the price of the house or comes out of the size or quality of the house.

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The auto dealers gave similar testimony. First, as one pointed out, the reduced sales resulting from high interest rates means that the higher fixed costs per car must be passed on to consumers through higher prices.

One of the most important of these costs is the interest which dealers must pay to carry their car and parts inventories. A dealer testified that the amount of interest he has to pay to carry a car in inventory has risen to $214 per car for 1981, compared to only $85 per car for 1980. Another has seen the cost of carrying his inventory triple during the past year.

Interest expenses are now the number one item on the balance sheet for many auto dealers, according to a Silver Spring Oldsmobile dealer. For a long time, rent was his biggest expense. This was supplanted about 8 or 9 years ago by advertising. But during the past year, interest expense on inventory financing has become hands-down the largest expense for his dealership.

Second, high interest rates are a significant obstacle in two respects to the effort to reduce the Federal deficit. First of all, they increase the carrying charge on the existing debt, thereby raising expenditures. Further, and very importantly, high interest rates have provoked a recession in certain sectors of the economy, with the result that workers who are laid off cease to be taxpayers and begin instead to draw unemployment compensation from the Treasury. The consequence of the slowdown in economic activity caused by high interest rates is a double penalty imposed on the effort to balance the Federal budget.

For homebuilding, there is just no doubt that the industry is in a severe depression. Virtually every homebuilder who testified has had to reduce his work force. One subcontractor who had 250 skilled craftsmen on his payroll last year is now down to 18 employees. Another builder testified that the 50 percent decline in homebuilding in Anne Arundel County has cost 3,000 construction jobs.

Almost every auto dealer who testified indicated that one way in which he has adjusted to high interest rates is by reducing his operation and laying off workers. One Baltimore dealer reported that he has cut employment in his dealership by 50 percent. A dealer from Annapolis cut his work force by 40 percent, from 42 employees 18 months ago to 26 employees today. Other dealers have made similar cuts.

The depressing effect of high interest rates causes unemployment all through the auto production chain. As a dealer said, if he does not order cars from the factory, the factory can't produce and production workers are laid off. In turn, the auto suppliers cut their operations and lay off their workers. These people, in turn, can't affort to buy cars, which further depresses the market. It is a vicious circle.

These workers have been changed from productive taxpayers into drawers of unemployment insurance, because of high interest rates.

A third extremely important point is that the enterprises being affected in the small business sector -- the auto dealers, farmers,

the homebuilding industry, and realtors -- are long-established, effective, efficient economic endeavors. They simply cannot handle the situation with which they are being confronted.

It is not marginal businesses which are unable to cope with this situation -- they fell by the wayside long ago. What is happening now is that long-established economic endeavors, recognized within their area of economic activity as being amongst the best in the business, are unable to work with current interest rates, are laying off employees, and in some instances have already closed down. We are seeing a tremendous weakening of the small business sector of our economy.

The situation is becoming virtually impossible today for even the best auto dealers. One told of a conversation with his banker, which started with his banker telling him he had the best operation in the State of Maryland and then telling him that the bank was pulling out of its arrangement for financing consumer purchases of his cars. Another, who last year was one of 70 dealers nationwide to win the Time Magazine's Quality Dealer Award and one of 26 imported car dealers to win Sports Illustrated's Dealer of Distinction Award, said "I am a good operator. But I cannot buck the interest rates that I am carrying now. I am paying two points over prime as of yesterday, or 22 percent," for carrying his automobile inventory.

The number of new car dealers in Maryland has declined to 375 from some 410 a year ago. Many of these were owned and operated by first-class businessmen who made important contributions to their local communities. They sold and serviced cars, they created jobs, they added to the local tax base, and they often helped run their local communities. Now, because of high

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interest rates, they are gradually going out of business, and we will all be worse off for it.

The same thing is happening in farming. Long-established farmers, who are widely recognized as being among the best in the business, are unable to work with current interest rates, are putting off investments and letting land lie fallow, and in some instances, are leaving farming. The only thing that has kept many farmers going, according to one from southern Maryland, is the fact that they love their land. Another, however, sees many foreclosures in the months ahead unless interest rates fall.

Fourth, current interest rates have created an absolute disincentive to investment. Businessmen and women, even in cases where they can continue to operate, now ask whether it makes good financial sense to do so when they can earn an immediate, greater return simply by investing their capital in money market funds. This striking disincentive to investment runs precisely counter to efforts to strengthen the national economy by promoting investment.

Small businessmen, auto dealers, farmers all testified that they would be better off putting their money into high-yield money-market certificates and certificates of deposit than making new productive investments in their businesses. Two Eastern Shore farmers testified that they would be financially better off putting their net worths into CD's than into their farms. A Baltimore small businessman gave a graphic example of how high interest rates are undermining the ability and willingness of businessmen to make investments that will improve their efficiency and productivity.

Fifth, at just the time when State and local government jurisdictions face sharp reductions in financial support from the Federal government, they also face serious obstacles in the bond market. At present, they are obliged to pay rates above 13 percent and to shorten significantly the term of their bond issues. Important capital improvements are being deferred, to the detriment of the economic infrastructure of local communities.

In Annapolis, Governor Hughes testified that high interest rates have forced him to set up a panel to find postponable capital spending, hoping that the interest saved from a one or two year delay will more than offset the increased cost from inflation.

Many of our local governments, however, just don't have any flexibility. Charles Gilchrist, who is the Montgomery County Executive, testified that the increase in interest rates just this year will add $2 million in first year costs to an $85 million bond issue being contemplated for this winter and that they have, as a result, considered cutting back on their borrowing. But, as he says:

> "To a great extent, that's impossible because we have planned carefully for the growth of our capital structure, and it would be impossible to limit it.
>
> "But even in the limited extent that we can cut back our capital program, we are faced with a 'Hobson's Choice,' because the projects are needed, not only to meet health and safety costs, but also to meet the economic development goals which underwrite our tax base."

He pointed out, for example, that failing to improve the roads in the Shady Grove area -- a high growth part of Montgomery County -- would cost the county as much as $40 million in its tax base from foregone development.

Janet Hoffman, a major financial adviser for the City of Baltimore, had a similar story. The city is a very prudent borrower going to the market only once a year for $35 million and it has an improved credit rating. Nonetheless, she reports that the financing cost per million dollars has tripled as has the tax rate needed to meet the higher interest costs.

The dilemma which faces Baltimore faces virtually every city in the United States. Here is how Janet Hoffman summed it up:

> "We know that our future as a city depends upon our ability to finance capital improvements. We do have a deteriorating infrastructure, and we do need capital improvements to continue to attract and retain investment. But as things now stand, we face decreased borrowing in purchase power terms, regardless of need. We face shorter maturities with an inequitable result, in terms of what generation is going to be paying for long-term improvements. And we face intolerably high interest costs."

Sixth, mortgage rates have eliminated all but 5-10 percent of American families from the housing market. With the notable exception of luxury and vacation homes, residential construction is almost at a standstill in Maryland. Today's mortgage rates impose a special hardship on those who must relocate for job reasons or who are in the military. The only families that can cope with the challenge of buying and selling a home under the pressure of time are those associated with large firms which can offer relocation assistance as a benefit of employment. In such cases, the firm takes over responsibility for the house when a move is required. The consequence of this is to place small business at an even greater disadvantage in relation to larger concerns.

Throughout the State of Maryland today, as well as throughout the rest of the country, the mortgage interest rate is above 18 percent. Realtors in every part of our State said that an 18 percent mortgage rate puts the median priced home in their area out of reach for all but those with very high incomes. For example, in Montgomery County where the median priced home is now around $115,000, a 20 percent down payment would give a mortgage of $92,000 and at 17 percent interest a monthly payment of $1,430. To qualify, a family would have to have an income of $61,300. By contrast, with an interest rate of 12 percent, the monthly payment would be $1,065 and the required income would be $46,000. That's $15,000 in annual income just to qualify for the same house at the higher interest rate. Only a small fraction of the Montgomery County families have an income over $61,000. All the rest are priced out of the market.

There is one aberration in the housing market that I want particularly to underscore - a disturbing trend toward a two-tiered economy. One lumber dealer on the Eastern Shore of Maryland, where there are virtually no homes being built for lower- or middle-income people, testified that there continues to be a boom in vacation and luxury homes. These are the only lumber sales he is making. We risk a situation in which homeowning becomes the prerogative of those at the very upper end of the income scale rather than a goal to which most Americans can aspire.

Seventh, it is impossible for a young person to take up farming unless, in the words of numerous witnesses, he inherits or marries into it. There was general agreement among farmer witnesses that investment in farm equipment is being deferred, with obvious adverse affects where productivity is concerned.

The discouraging impact of high interest rates on young farmers is illustrated by the following example provided by one farmer. At last year's interest rate -- 9-3/4 percent -- a farm purchased with a $200,000 mortgage for 30 years would have a monthly payment of $1,718; at today's interest rate, the monthly payment is $2,212, an increase of $494 per month. Over the 30 year life of the loan, total payments at last year's rate would have amounted to $618,000. Under today's interest rate, total payment would come to $796,000, an increase of $178,000. This has made it virtually impossible for young people to get into farming today.

In addition, the high cost of borrowing is forcing many farmers to postpone productive investments, which will cost consumers dearly as the efficiency of our agricultural sector gradually deteriorates. As a farmer from Southern Maryland told the Subcommittee, patching up old machinery to make it go another year just is not an efficient way to operate. It adds to down time, idles labor, and if time runs out on broken equipment, "you can lose a crop."

The purchase of farm equipment is obviously being deferred even though the farmer calculates that the addition of such equipment will make him a more effective and efficient producer, thereby increasing his productivity. Yet when he confronts the high interest

rates that are associated with acquiring the equipment, he is simply not able to go forward. In fact, one Eastern Shore farm equipment dealer said that with today's interest rates, he could not in good conscience advise his customers to purchase new equipment, even though he currently has over half a million dollars in inventory on which he is paying a carrying charge of as much as 24 percent.

These are only some of the more serious and striking distortions in business and community patterns which were brought out during the course of these hearings. It is clear that unless interest rates are brought down to a level where productive enterprises can carry on their businesses, our economy is going to lose a whole range of economic enterprises of proven efficiency and productivity. The witnesses we heard from were invariably the leading business people in their fields; these were people who have been productive and effective economic contributors for a sustained period of time.

The message from all of them was that they clearly cannot handle the situation with which they are now confronted. Our hearings underscore the enormous importance of addressing this interest rate problems and urging a prompt change in policy.

Senator SARBANES. Mr. Chairman, at your suggestion it was deemed helpful and wise—and I think it is—to bring here before the committee representatives of those witnesses whom we heard in the course of the extended week's hearings. And we have here some of the leading people, Bill Cairns, an auto dealer from Marlow Heights; James Grady, a small businessman with his own service station out in Baltimore County, Md.; Martin Poretsky, a homebuilder in the Washington metropolitan area; Hursey Porter, who is the president of the Maryland Association of Realtors from the eastern shore of our State; and Willma Reeves, who is, with her husband, one of our leading farmers in southern Maryland.

They are among the witnesses we heard. I think it is important that they have this opportunity to present their testimony here this morning. I am very pleased that they are here before the committee.

Representative REUSS. Well, thank you, Senator Sarbanes.

And we welcome you, Mr. Cairns, Mr. Grady, Mr. Poretsky, Mr. Porter, and Mrs. Reeves.

Senator Sarbanes, I would appreciate it if you would perhaps take over and recognize your fellow Marylanders, and that way we can get the picture.

Senator SARBANES. Mr. Chairman, reflecting some old-fashioned values of mine, why don't we go with Mrs. Reeves first.

STATEMENT OF WILLMA REEVES, PRIVATE FARMER, CHAPTICO, ST. MARYS COUNTY, MD.

Mrs. REEVES. Mr. Chairman and ladies and gentlemen, I want to thank you for the opportunity to speak here, to try to point out some of the problems of the farmers of southern Maryland.

I am Willma Reeves. My husband and I operate a family farm in Chaptico, St. Marys County, Md. We have been full-time farmers since 1946, when he was discharged from the Air Force after World War II.

I have been concerned for some time—and I have said so—about farming in general in this country. The family farm of America has been the most efficient food factory and the most dependable source of exportable goods of any country in the world. Four percent of the population provide food and fiber for the other 96 percent, and enough extra for import to make a significant impact on our balance of trade.

But the farmer faces obstacles that are beyond his good management and hard work and long hours to overcome. The weather will give him some good crops or bad years, but they do seem to even out, and are planned for and managed, with a little help. The value of his produce is determined by the buyer. He sells by asking, "What will you give me?" Never any cost of production, cost of living, interest on investment is figured in or considered.

The fixed cost of planting a crop has increased at an alarming rate in the last few years. Good seed, fertilizer, fuel for machinery, and replacement of equipment is determined and caused by our different method of marketing. The inflation and interest rates we have been experiencing have priced the land beyond any possibility of crops grown on it to ever pay for it.

Two bankers I've talked to recently both say they cannot lend money to buy land, at present price and interest rates, for a strictly farm operation. Each, in figuring a farm management and repayment

plan, says they must have one family member with a good-paying outside job, to meet today's interest rates. One says that with a good farm operation, with very little debt outstanding, it is possible to borrow to add additional land—with caution.

I can give examples of good farmers getting in serious financial trouble, trying to enlarge. We have always had an occasional farmer who made some bad decisions and ended up having to sell out, and try something else. Neighboring farmers were able to borrow the money to buy the land and equipment, and work it into their operation.

But in the last month, foreclosure proceedings have been started on three farms. This is something that has not happened in the last 30 years.

Farm machinery dealers are feeling the pinch, and are in trouble. Good farm machinery dealers, fertilizers and lime suppliers, and available markets are all necessary to a farm operation. One local dealer says he is spending his time patching up equipment that should be on the junk heap.

But, at $60,000 for the smallest combine cornpicker, the farmer would be paying $11,340 a year in interest, at present rates, and would have to pick or combine 500 acres of grain just to pay the interest. That size machine, with the owner operating it for wheat and corn and then soybeans, can't harvest much more than that.

Farmers have been helped by good research, by the Extension Service, good machinery developed by manufacturers, and innovative ways to fertilize and control weeds and insects. The comparative efficiency of the system might be illustrated by a few statistics:

In 1948, a postage stamp sent a letter across the country for 3 cents; a loaf of bread cost 13 cents; and wheat brought $3 a bushel. Today, that stamp will cost you 18 cents; the bread, from 70 cents to a $1; and the wheat still brings the farmer $3 a bushel.

I would like to suggest that it is time for you to worry, and you should be very concerned the next time your television commentator says, "Good news: Farm prices are down."

Thank you.

Representative REUSS. Thank you, Mrs. Reeves.

Senator SARBANES. I think, Mr. Chairman, if we could hear from Mr. Grady, who is one of our leading small businessmen; and then Mr. Cairns, one of our leading auto people; and then we will do the realtors and the homebuilders together.

STATEMENT OF JAMES E. GRADY, OWNER/OPERATOR OF WOODBROOK EXXON, BALTIMORE, MD., AND CHAIRMAN, GOVERNMENTAL RELATIONS COMMITTEE OF THE SMALL BUSINESS COUNCIL OF THE BALTIMORE COUNTY CHAMBER OF COMMERCE

Mr. GRADY. Thank you, Mr. Chairman.

I am Jim Grady. I own and operate a service station in Baltimore County. I went into business on May 1, 1979. The capital that I used was mostly from savings from an earlier career. I did, however, determine to bring a modern car care center to this neighborhood which didn't have one, and so I did borrow money for electronic equipment to be used—such as engine analysis, wheel balancing, front-end alinement.

I thought I had a pretty good loan, tied to prime. The first payment came due on June 1, 1979, at 10.5 percent interest. This same

loan—my 12th payment was due May 1 of last year, at 18.75 percent interest. The 28th payment, which I made on the first of this month, came due at 20.75 percent interest. This is one of the very few contingencies I did not plan on when I went into my own business.

In the generation in which I grew up, you expected to pay this kind of interest if you borrowed from the proverbial "loan shark." I am now faced with a dilemma in my business. It's time to invest in some new equipment. Engine analysis equipment is now designed to measure carbon monoxide and hydrocarbons; and, while there is no law in place in Maryland just yet to measure these poisonous emissions, I happen to be in a neighborhood where a great many car owners would come in for a periodic checkup along these lines, not only for the environmental benefit but a proper emission means a well tuned car and fuel economy, which is just as important in today's economy.

I have looked at the various pieces of equipment on the market, and they are not as stunning as the prices on some of that farm equipment just mentioned, but they run from $15,000 to $23,000.

Now, I have been successful enough to save a portion of this money invested in CD's and money market certificates, but I am faced with the dilemma of giving up these savings that are earning 13 to 17 percent, and taking the rest in a 21-percent interest loan. It is a turnaround on my money of 35 percent.

The question facing me, as a small businessman, is: Can I afford to make that kind of an investment in what I think is usury?

At 10-percent interest or 12-percent interest, I wouldn't hesitate in making these purchases and stimulate the local economy, because the three companies I'm considering are all operating in the suburbs of Washington, D.C.

My second problem is my tow truck. It is approaching 7 years of age and becoming a liability on the road, but there is another $20,000 investment. And at 21 percent, either Ford or General Motors is going to have to wait.

I'm not going to get into these areas, because I see we have real estate and car dealers here. But my own personal experience—I would love to move closer to my business that I bought 2½ years ago, but I will be darned if I'm going to give up a 7-percent interest in Phoenix, Md., to move 15 or 20 miles closer to the Homeland area.

We have for years, been a two-car family. My wife is sitting in the audience; and we trade her car in every 4 years, and mine every 4, so that every other year I would be renewing a 24-month loan at one of the local banks here. I stopped that last year. I don't know what the consequences will be, but hundreds of my own customers have done the same thing. In a way, it is to my advantage, because they're bringing these older cars in for service. But these are the problems.

I am not an economist; as your previous speaker, I don't pretend to know the answers. But I can tell you sincerely that, in my own limited and personal world, if interest rates were to be moderated, thousands and thousands of dollars would be immediately poured into the economy.

Thank you, sir.

Representative REUSS. Thank you very much, Mr. Grady.

[The prepared statement of Mr. Grady follows:]

Prepared Statement of James E. Grady

Thank you, Mr. Chairman.

I am James E. Grady, owner/operator of Woodbrook Exxon and chairman of the Governmental Relations committee of the Small Business Council of the Baltimore County Chamber of Commerce. Baltimore County has a population of 670,000 people; it is an urban county with over 10,000 businesses and industries.

The Small Business Council represents 85% of the Chamber's 500 members.

If I may be blunt, high interest rates are driving many small businesses to the wall! Let me cite a few critical potential consequences of high interest rates:

-plans to replace necessary plant and equipment will be postponed or abandoned.

-reduced ability of business to expand; impacts upon those seeking jobs, particularly minorities and other disadvantaged groups.

-for many, current interest rates threaten even survival profits, let alone profits that are enticing enough to attract investors.

-letting small business fail can lead to reduced levels of competition with potential disadvantages for the consuming public.

-high interest rates limit our domestic firms' ability to compete with foreign competition.

-consumers lose when free customer services are discontinued.

Let me personalize these statements by showing the committee the impact on my own business decisions.

As owner/operator of Woodbrook Exxon, on Charles Street in Baltimore County, I entered business on May 1, 1979. Most capital was savings from a previous career that went into inventory and working capital. But I was determined to bring a modern car care center to Charles Street, so I did

borrow money to acquire electronic equipment for engine analysis, front end alignment and wheel balancing (see invoice). The first payment was made on June 1, 1979 at 10.5%, and the twelfth payment was made on May 1, 1980 at 18.25%.

But now I have a dilemma caused by these high interest rates. I should buy two new items - advanced engine analyzers that now include emissions testing of Carbon monoxide and Hydrocarbons. Maryland has not yet made it mandatory to measure these poisonous emissions, but in my neighborhood, there are a great many car owners willing to pay for such services periodically, not only because of the environmental benefit, but also because proper emissions mean maximum fuel economy. The various pieces I have looked at cost from $15,000 - $23,000 for a complete unit. I have been successful enough that I have most of the money in Certificates of Deposit or money certificates earning 13% -17%. Do I cash these in and take the rest in a 21% loan (a total turn-around of about 35%)? Can I make enough to warrant that committment to what I feel is "usury?"

At 10% interest I wouldn't hesitate to stimulate the economy, as I would purchase equipment from Allen, Sun or Marquette, as would hundreds of other dealers in Maryland and thousands of others in the country.

My tow truck is nearly seven years old and becoming a liability on the road. Here is another $20,000 investment I would make - but not at 21% interest. Ford or GM will have to wait.

Finally, I am probably driving real estate people nuts looking at most houses that come on the market in my neighborhood. I would like to move closer in towards my business, but I <u>will not</u> give up a 7% mortgage in Phoenix, Maryland for an 18% mortgage in Homeland or Ruxton just to be fifteen miles closer to work.

Senator, those are the problems. I am not an economist and don't pretend to have the answers, but I can state sincerely that in my own limited and personal world thousands and thousands of dollars would be poured into the economy if interest rates were lower.

Representative REUSS. Mr. Cairns.

STATEMENT OF BILL CAIRNS, OWNER, BILL CAIRNS PONTIAC, MARLOW HEIGHTS, MD.

Mr. CAIRNS. Good morning, and thank you for having me here this morning.

My name is Bill Cairns. I am a Pontiac automobile dealer, not very far from here, in Marlow Heights, Md.

About 4 years ago, I decided to build a new facility in Marlow Heights, Md. I had a Pontiac dealership about a half mile from where my new place is. It was kind of old and run down, and not a very nice place to go to work at every day.

So, I decided to build a new facility. I purchased the land. I went to the local bank, and they told me they would give me a loan. At this time the commitment for the loan was 9.5 percent, which was very good. Well, when you want to build a large facility or anything such as that in real estate, it takes a little bit longer to get into the ground and get it finished.

This delay has cost me an awful lot of money, because we didn't get finished until February of 1980, and the bank at that time had to back out of the commitment of 9.5 percent because of the rise at that time in the prime rate. They just did not have the funds to give me to build my building, so I had to go elsewhere.

At that time, I was able to secure a loan from a different lending institution, at 1.5 over prime. At that time, it didn't seem that bad either, because I think prime was around 10 percent.

Well, in the last 12 months, as an example, I—a small automobile dealer in Marlow Heights, Md.—have paid over $1 million in interest alone. That is a staggering figure. That is about twice what I should have paid, without a doubt.

Also, if the prime was not at 20 percent or 22 percent, there are a lot of things that could happen. For instance, let's just say today, if the prime was at a reasonable rate of 14 percent—and I never would have believed I would have said that 14 percent would be a reasonable rate for the prime rate—but if it was at 14 percent, there are a lot of good things that could happen in this country.

It would be like playing dominos. When you hit one, they would all fall down. That is the way I look at it, anyway. I would be able to stock about 200 more cars in my auto dealership, rather than the amount of cars I have for my customers to select from today. Unfortunately, the more inventory you have—no matter whether you're selling chickens, eggs, or automobiles—the easier it is for the consumer to select, and the more they will buy.

If I could have prime at 14 or thereabouts, I would have more cars in stock; I would probably sell about 75 more automobiles a month. If I then sold 75 more automobiles a month, I would probably have to hire another six or eight salesmen. And then, in about 3 months from now, I would have to have another half a dozen or so mechanics to service those cars. And maybe 3 months from that, a few more body men, because unfortunately, some of those people would crash those cars.

I would have to have more people in the administrative office. There would be more girls in the office—just more people all around the dealership.

Well, then, the dominos really start to fall, because I would have to buy those cars from General Motors. And they would put more people back to work, back in Detroit. And really, as close as Baltimore, right here in Maryland; there's a very large General Motors plant in the city of Baltimore.

If I could sell 75 more cars a month, there are some dealers that would sell 175 more a month, and some who would only sell 5 more a month. But it would put all of those good people in Baltimore and Detroit, and everywhere else, back to work pretty quick.

There are other people that are related to this industry, such as tires in Cleveland and Indianapolis and Chicago. Compared to those places, we in the Washington-Baltimore area are on somewhat of a gravy train. I have some friends that have car dealerships in Cleveland and Indianapolis, and it is really the pits there—excuse me for the expression, but it is really, really bad.

A lot of good, sound businessmen have gone under in the last 12 months. All the shaky guys have been out of the action for at least 2 years. The real shame of the matter is today, we are losing guys—and girls—that have been in business, and their families in business, for second and third generations.

And they are just locking the doors of their one-time family-owned auto dealerships. And they are turning what was an auto dealership into real estate cash, by selling it out, although a lot of them are locking the doors and can't even sell their real estate at this time, even though it does have a large value, because of the high cost of money. And who wants to buy?

There are just so many things that could possibly happen if this prime would come down. It is really, really hurting the small businessman and the medium businessman.

You know, the automobiles have gone up an awful lot in the last couple of years. And I'm sure that part of that built-in cost has been because of high interest rates. They have to pass those costs on to the dealer, who then has to pass this cost on to the consumer.

As I stated, I paid over $1 million in interest in the last 12 months, half being on my building and approximately half being on the cost to floor plan the cars that I sell to my customers, the consumers. And the consumer is the poor guy that eventually takes the rap. It is just part of the domino action.

Somebody has got to pay. And if the consumer is paying all of these high interest rates, how in the world is the prime rate's being at 20 percent help inflation? And most of the people in business that I know, that have been forced to borrow money in the last 12 or 18 months, would not have had to borrow money if the prime rate wasn't so high.

In my industry and in most industries that have to store goods—whether it's grain for the farmer or cars for the dealer or hogs for a farmer—the highest cost in our industry today, or in our business, on the liability side of the financial statement is interest.

It just has got to come down, or there's going to be more and more people who suffer, especially the consumer, in the coming months.

Thank you for having me here today.

Representative REUSS. Thank you, Mr. Cairns.

Mr. Poretsky.

Mr. PORETSKY. Do you want the homebuilders to go now?

Senator SARBANES. Do you have a preferred order?
Mr. PORETSKY. I was just listening to your original order.
Senator SARBANES. Why don't you go ahead.

STATEMENT OF MARTIN PORETSKY, PORETSKY & STARR, INC., BETHESDA, MD., AND PRESIDENT, METROPOLITAN BUILDERS COUNCIL

Mr. PORETSKY. Thank you both for the opportunity of being here this morning.

For the record, my name is Martin Poretsky, and I am presently the national representative for the State of Maryland to the National Association of Home Builders. I am currently president of the Metropolitan Washington Builders Council, which is a composite of the Maryland, Virginia, and the District of Columbia local associations. And I am president of Poretsky & Starr, Inc., a commercial firm in this area.

I am also joined today by Carl Buscher, who is the executive vice president of the State of Maryland Institute of Home Builders; and Pat McCuan, a builder from Baltimore and Columbia, Md., who is our legislative chairman for this coming year.

At one of Senator Sarbanes' hearings around the State another spokesman said to him that, in earlier times, if a messenger brought bad tidings, the messenger was killed. I can only ask you today not to kill this messenger, and to please stop killing my peers.

Last week's cover story in Forbes magazine was entitled: "Where Will the Money Come From?" It didn't really have a straight answer, but it states:

> An industry that finds 90 percent of its perspective customers priced out of the market is not a business, but a disaster.

Last night, I was with the Hagerstown, Md., Home Builders. They had sent a flyer out, announcing the topic of the discussion for the evening, which I was supposed to be party to, was: "How To Survive the Crunch." I received no applause when I was through speaking. Indeed, my partner simply asked me, before I left: "Would you mind telling me how we're going to survive, before you tell anybody else?"

We have been in business for over 12 years. I am a third-generation builder; so is my partner.

At a hearing in Rockville, Md., Johnny Walker, who is a fourth-generation builder, spoke. He wonders whether or not there will be a fifth generation for him or a fourth for me. And it is not our fault. We are fast approaching a situation in which there are only two kinds of builders—broke or out of business.

Now, the out-of-business builder does have two definitions to it. It could be someone who has done very well in the past and just is presently weathering the storm. But he may have had, at one point, 5, 10, 20, or 100 employees that he presently has now put on unemployment.

Now, housing, unfortunately, has been a cyclical business with downturns in the past. And economists have studied this cycle theory, and they have told me—at lectures and seminars that I've attended—that the cycles usually last for a total of 6 years, when they have

charted them. Six years, going from the best year, turning downward, reaching a medium point, going below, bottoming out, and starting back up again. The entire cycle would take 6 years.

Now, in each one of these instances, upon reaching the bottom, one could almost immediately see the light at the end of the tunnel. We have been in a tunnel now for over 2 years. There is no light at the end of it, and I will be darned if I can even find any faint red-lantern exit sign, to speak of.

And you are talking about established, well-managed, service-oriented firms that are going out of business. We are almost one-fifth of the way through the highly touted decade of the 1980's. This was the time that was supposed to be existing of unprecedented housing demand. The baby boom generation has hit the market: We want 2 million houses a year, and so forth.

We are in a crisis. Forbes again says that:

> How else can we characterize a situation where demand for new housing is 2 million units per year, but the construction rate is barely 1 million. Given today's interest rates, less than 10 percent of American families can afford to carry a mortgage payment big enough to swing a medium-priced home.

My question to you: If this is what demand is, how long will it take, not for us to catch up with what we can presently sell, but we're going to have a backlog that will never be accomplished.

Carl Boscher, who is with me, is our executive vice president, as I mentioned earlier. He moved to Annapolis about a year ago to take his position with our association. He moved down here from New Jersey. His family is still in New Jersey. He has been unable to sell his home; consequently, he cannot buy another, and he must limit himself to seeing his family every other weekend.

On the other hand, more and more singles, priced out of the market, pair up and pair up again, so you have two, three, four singles living together. We are creating a situation that nobody has really analyzed yet, to understand whether or not it is deeply threatening the moral fiber and structure of our society in this country today.

Take a moment to consider the cost of a mortgage. I have a handout here, Senator, that we went through with you in Maryland, that another Maryland builder, Mike Rose, had prepared. And the bottom line of this study shows that at 18⅝ percent interest, neither a U.S. Senator, Congressman, nor the Governor of Maryland can buy a $90,000 townhouse in nearby Prince Georges County today, which is not the affluent suburb of this region.

Even at 12-percent interest, one would have to make over $46,000 just to qualify for that townhouse. And this chart that I'm looking at doesn't even go below 14-percent interest.

A few local statistics that I am painfully aware of. According to Montgomery County Executive Charles Gilchrist, the average annual demand in his county for housing is 7,760 single-family dwelling units per year. In 1980, 4,978 units were produced. At the present production rate, only 1,240 units will be produced this year in that county. In Prince Georges County, new home sales were off 69 percent from the summer of 1980. And I pointed out that 1980 was not a good year.

The kickout rate in Prince Georges County—houses that are sold but do not go to settlement—has tripled the 1980 rate. One in six

homes today that is contracted for never gets to settlement. What happens then? As a prudent builder, I would not have started that house in the first place; however, someone has signed a contract with me, and I must honor that contract. So at that time, to honor that contract, I begin to construct the home. If at the end that house is completed but that deal has fallen through, I am now suddenly carrying a finished product at an interest rate that even has paled the 18⅝ percent mortgage, because I am paying two over prime. I am paying 22½–23 percent, to carry a finished home.

Now, new homes are not marked up with a large margin as many retail items are. Our profit margins are well below 10 percent, even in a well-managed firm in good times. I understand secondhandedly that a study conducted of homebuilding firms across the country last year, showed that for those firms that made a profit, the average profit was less than 1.8 percent.

So you can see it doesn't take long to go through a very small cushion if you are carrying a finished home at 22½ percent. You can now understand why the failure rate among construction firms is now up 41 percent in the first 8 months of 1981 compared to the same period of 1980.

The subcontractors failure rate is up 120 percent. By our present statistics, we now have over 800,000 people unemployed in construction and by the end of this year there will be over a million. In the past, our industry was willing to bite the bullet, sacrifice for the good of the country. But I have to ask you, what benefit is being derived from the ruination of decent businessmen? Who gains today when a young married couple can't find shelter to form a home?

We need your help. The inflation rate, as I understand it, has come down, but the interest rates have not. I cannot simply cut the size of a home to proportionately reduce the cost of a home to a purchaser. The soft costs today of a home are nearly 60 percent of the cost of the house. If I reduce the 1,500-square-foot house by one-third, to 1,000 square feet, I could not reduce the sale price a full one-sixth.

As you know, today home buyers are searching for mortgages but they are competing with everybody. They are competing with you, the Government. They are competing with Du Pont when they take money out to credit their financing of Conoco. Their money market funds—these are all the same dollars. I have been told, and I heard it from the Federal Reserve Board last week in Boston, that large takeovers and mergers and acquisitions have "no effect on the economy." Dollars of credit are withheld from one area, but they are put into another, and they put their way back into the economy.

Well, unlike my carpenters and their families and their framing skills, I do not see new jobs created or productivity increased, but I do see large chunks of capital removed from the marketplace, albeit for a period of time, and during that period of time they are unavailable for others to use during that interval. Although eventually it comes back into the economic stream, and the ultimate economic picture might be OK as a washout, we builders have been faced with this logic before. Our industry has been used as a spigot: You have turned us on, you've turned us off, you've turned us on, you've turned us off. We can't respond that quickly. We take 3 to 6 months to gear up or to gear down.

Well, I am talking to you right now. I am asking for your help, not for me and not for the people that are not going to make it for the rest of this year, because they are gone. I am talking about people in 1982, because that is the earliest, if you did something today, that a builder in trouble could be helped.

The money market funds. The money market funds have made a professional financial adviser out of my 3½-year-old and 9½-year-old daughters because they have got a few thousand dollars in them. This is why, to those people that are not involved in an interest-sensitive business—as we are—I really question whether there is any real incentive to help bring the inflation or the interest rate down, because some people are being benefited by that.

I have two avenues that I asked you to help us with, therefore, in maintaining the supply of money for which we must compete, and those two I have referred to. Now, a third and final situation—this is from a quotation in Business Week, September 7. It said: "If housing is to prosper, it must find ways to build a new secondary market of private investors."

Concerning pension funds, we need your help. The influence of your names and offices within your own States, to help put pension funds into housing, starting with the State pension funds. Did you know that the national average last year of the yields on State pension fund portfolios was about only 8 percent? Why? Below-market financing for mortgages would provide a much greater return.

Think of all the possibilities. Needed shelter provided, a solid job base in your very own State from construction, encouraging the fulfillment of the American dream in your hometown. We need you to help bite the bullet with us, by providing the intelligent, decisive action that we need. We need it now, for tomorrow.

Thank you.

Representative Reuss. Thank you.

Mr. Porter, please proceed.

STATEMENT OF R. HURSEY PORTER, JR., PRESIDENT, MARYLAND ASSOCIATION OF REALTORS, SALISBURY, MD.

Mr. Porter. Mr. Chairman, Senator Sarbanes, I am Hursey Porter from Salisbury, Md., and I am president of the Maryland Association of Realtors. Our association is a part of the National Association of Realtors, and we have some 20,000 members located throughout the State of Maryland. I want to thank you and the committee for your concern on this very critical problem of high interest rates we are experiencing today.

I am dismayed this morning, however, that Mr. Weidenbaum could not be here to hear the testimonies that are coming forth from the small business segments and agriculture.

Senator Sarbanes. It was our hope when we had originally planned this hearing that he would testify, and that therefore he would hear some of your testimony, and respond to it. Unfortunately, as it developed, he had to make an appointment at the White House, as was indicated, and we had to reverse the order of the witnesses.

But I think your point is well taken. That was the initial plan, and we had hoped to have Mr. Weidenbaum here at least to hear part of

this testimony, because I don't think there is a full appreciation there of what is happening at the grassroots, as you are spelling it out here before the committee.

Representative REUSS. I will see, Mr. Porter, that Mr. Weidenbaum gets a transcript of this testimony. And I hope he will read it. It isn't as good as hearing it, but it will be helpful.

Mr. PORTER. Thank you, Mr. Chairman. I am a real estate broker myself, in Salisbury, Md., a small city on Maryland's Eastern Shore. Many of my remarks today are things that you have already heard in testimony this morning, and they are certainly a lot of things that you are going to hear in the future. In my remarks, I hope that I will reflect the effect of what interest rates are having on the home buying and the home selling public—not just the real estate industry.

The severity of the unprecedented high interest rates we have experienced, especially over the past 2 or 3 months, has devastated much, if not practically all, of the housing industry, as we have already heard. We feel that in the real estate industry, it is now reaching—has reached, a crisis stage, and that it is soon, if it is not already, going to affect the entire economy. As we all know, housing is one of the first areas to be hit by excessively high interest rates, because of the long-term credit requirements of the buying public.

Unfortunately, today, over 90 percent—and I venture to say maybe closer to 95 percent—of our citizenry cannot afford to buy a home. Most recently, on September 10, I and some of the staff of the National and the Maryland Association of Realtors visited with many of our congressional leaders in Washington.

And interestingly enough, from some testimony here this morning, one of the Congressmen that we met with stated that he and his wife had looked at a home within a reasonable proximity of where they are living now, to discover that they did not qualify on his salary to purchase it. I don't think we had to make our point too much stronger from that point on.

I venture to say that today 70 percent of Americans could not afford to refinance the homes that they are currently living in, if they had to go out into the open market. The number of American homeowners late on their mortgage payments has reached the highest rate recorded since recordkeeping began in 1953, according to statistics released by the Mortgage Bankers Association of America. As I stated before, I am a real estate broker in Salisbury, Md., and I would like to give you some facts as to what has happened to housing in our area.

I don't like statistics, but I guess that is what we have to deal with today. Wicomico County, Md., a community of approximately 45,000 people, sales are off approximately 37 percent for the year to date compared to 1980. Mr. Chairman, last year the sales were off 25 percent compared to 1979. If we couple last year's sales, off sales, and this year's off sales, we have a combined total of well over 50 percent off in housing sales in our area. Today, the figures show that housing sales in our area are off 53 percent, compared to August of last year. This time last year we did see a reduction in the interest rates. We saw a relaxation in the monetary policies of the Federal Reserve that gave our industry a shot in the arm that we are not experiencing this year. It has gone just the opposite direction during the same quarter.

To give you an idea of other areas of Maryland, particularly the Baltimore metropolitan area, home sales were off 31 percent in August of this year compared to August of last year, and they had very large losses last year compared to 1979. This year they have 963 sales, compared to 1,408 last year.

Recently in testimony before this committee's subcommittee in Annapolis, which was conducted by Senator Sarbanes, the Governor of Maryland very clearly testified that there were insufficient funds in a program known as the Maryland home financing program, which was a tax-exempt bond sales program in Maryland—insufficient funds to cover the demand.

Mr. Chairman, in my office alone in Salisbury, Md., we submitted seven contracts of sale on homes pending that type of financing, which, at that time, was available at 10 percent. This has been in the past couple of months. We had 1 individual selected out of 7, because there were 14 applicants from our particular county.

I cannot stress to you the disappointment on the faces of those potential home buyers. These were first-time home buyers. We had a couple of them in our office that were in tears, because they were not selected, because it was drawn as a lottery. So you can clearly see that the demand is there.

Another interesting figure I guess we could take a look at today is that over 70 percent of the sales in which our company is involved—is negotiating—is called "creative financing." Mr. Chairman, this is unconventional financing. We are not going to the banks. No one can afford 17- or 18-percent interest rates. We heard testimony this morning from Mr. Weidenbaum about the reduction in the prime rate.

Let me say this very unequivocally before this committee, that there is very little difference as far as a consumer is concerned between 16 and 20 percent, because most of them cannot afford either one. What is happening in financing, what home sales we are financing is the sellers are taking back mortgages. We, in many cases, are finding that second mortgages are required. This is not the answer on a long-term basis. As president of the Maryland Association of Realtors, I can say very authoritatively that the figures that I have quoted to you thus far concerning Wicomico County will hold true for the entire State. Again, if we couple the loses of 1980 to the 1979 figures, we are experiencing probably 50 percent off sales in homes throughout our industry.

As for the plight of the homeowner or the homebuilder—because I am not here to gain sympathy for the real estate agent; I think we are past due that stage—I want to say it is a very sad story indeed. When you look at an individual who must sell his home today for one reason or another, whether he be transferred, whether he be in financial difficulties or what have you, every day in our office we are hearing cries of "help" from the home sellers.

Please consider the situation where one has lost his job for a period of 6 months. He has not been able to regain employment in his specified field, and has approximately 30-percent equity in his home—he had approximately 30-percent equity. He cannot make his mortgage payments, and unfortunately, Mr. Chairman, he cannot sell his home today, because of the high interest rates. His equity is dwindling. He is on the verge of financial collapse and, in many cases, foreclosure may be imminent.

It is a sad story, but we are seeing it, and we are facing it every day. New home starts are practically nonexistent in our area. And I understand this is the case throughout most of the State and the country. It is no longer a case of profit for homebuilders; it is a matter of how much loss and how long can they withstand it. As we have heard here this morning, these are not marginally managed companies, but these are well-managed companies with long reputations.

In our area alone, one of our most successful homebuilders in the Salisbury area, who has been in the business for well over 30 years, reports that they would normally be building 50 homes to 60 homes on an annual basis. This represents in our community approximately $3 million to the local economy. This year, he has constructed 8 homes, and he has 10 sitting on the market unsold—no sales since the first of June. And he has three foundations in the ground, upon which nothing will be built until there is a change in the financial markets or until market activity increases.

This is the type of nonproductive thinking that we are experiencing in this country today. The week of September 7, Mr. Chairman, the Maryland Association of Realtors conducted what was known throughout our State as Interest Rate Crisis Week. As an example, I would submit to you an ad that was run in the southern Maryland papers by the Southern Maryland Board of Realtors. In that ad, we gave the following message to the public, to write in to you gentlemen, the President of the United States, and the Federal Reserve, that record-high interest rates are severely affecting our economy and that now is the time for the administration, for the Congress, and the Federal Reserve to work together to bring the rates down, and to please do it now for the sake of our country's economic future.

In Salisbury, Md., alone in an 1½-hour venture into the small business community, we picked up over 3,500 letters that were submitted to Senator Sarbanes and Congressman Dyson and Senator Mathias and the President of the United States, and Mr. Volcker. I think that, in itself, tells the concern of the general public. It isn't just small business and it certainly isn't just the real estate or the housing industry.

Yes, we are feeling the plight, as far as people having to get out of our business. I want to share with you very quickly, in the interest of time, that some of the impact—economic impact—that the loss of home sales has in a community. The National Association of Realtors Economic and Research Division estimates that over the past 34 months—and that is since 1978, which I think my builder friends will agree is when we saw our last norm of a market—for the past 34 months, there have been 2.5 million units that have not sold in this country, home units that would have sold had we had a stable economy and lower interest rates. These 2.5 million units, Mr. Chairman, represent a loss to our American economy of $175.6 billion. In Maryland alone, the National Association of Realtors estimates that over 40,000 units have remained unsold over that 34-month period. In Maryland alone, this represents over $3 billion lost into the economy.

Further, according to the National Association—and this is something that I had not really thought about so much before, and being a real estate broker for 16 years—between $5,000 and $7,000 goes back

into the local economy for every transaction on an existing home. This is not on a new home. The new home construction represents more. This is an existing home.

And it is very easy to see how this revenue is lost: up to $500 to $1,000 in presale fix-up expenses—sellers do repair homes before they put them on the market; $2,500 to $3,500 at the time of sale for moving expenses, legal fees, surveys, and local government fees and taxes such as transfer tax; closing cost—in other words, after-sale expenditures, capital improvements, furnishings, paint, et cetera, $2,000 to $2,500.

Mr. Chairman, these figures do not represent any real estate commissions earned. I happen to spend my money in my community where I earn it, and so does every agent within my office. But this $5,000 to $7,000 per existing home transaction that goes into the local economy does not include a real estate commission. Is it any wonder that today we are hearing the plight from painters and contractors and wallpaper salespeople and paint stores? They are saying, "Yet, we are in a period of hard times." But do they really relate it to the fact that home sales are off as significantly as they are?

We have—I am not an economist, but we have some what we think are some solutions, we hope, to this plight, at least some suggestions.

First of all, we hope that the further reductions in Federal spending, thus reducing the credit demands by the Federal Government, will help the situation. I don't know that it is the entire answer. We applaud the President for his concerns about the budget, and we hope that Congress on a bipartisan basis will work toward reducing Federal spending.

Second, we are hopeful for immediate attention by Congress to the plight of the Nation's thrift institutions. The effects of the money market funds that have been created in this country have been catastrophic. We have heard that in testimony this morning. There is no reason today for individuals in this country to receive 18 and 19 percent when we have a true inflation rate of 7 to 8 percent, not the 10.6 percent that the CPI came out with yesterday, because of the cost of mortgage financing at 18 percent.

I was in a meeting in Aberdeen, Md., last night, in front of 150 real estate people, and I asked the question, because I was deeply concerned: How many of you have sold a home in the past 30 days with an 18 percent mortgage rate? And we had two hands go up. Now, why is the CPI considering the interest rate consideration as far as the overall inflation rate?

Third, and I think most importantly, Mr. Chairman, is we ask that the Federal Reserve and the Treasury Department to act quickly, and I mean quickly, to reduce the stranglehold on this economy. A tourniquet to the throat is not a cure for a bleeding finger. I think we have all seen ads in the newspapers where the Federal Reserve was depicted as the doctor and the U.S. economy was the patient. And the nurse on the side said, "it's an excellent operation, Doctor; it's a pity that the patient died."

Our industry, ironically, and I say "our industry," the real estate industry very much supported much of the economic program that is in place today, not all of it, but most of it. And we have been willing to take our pain. We've been willing to take our lumps as the home-building industry has. But I think that it has gone far enough.

Mr. Chairman, in summation, if we can go back just one moment to the 2.4 million units in this country that have not sold over the past 33 months, and if we used the $7,000 impact figure that goes into the economies of this country, it is clear to see that for the past 34 erratic months, it has cost our local economies in excess of $17 billion. $17 billion that is money in which tax revenues can come into the Federal Government to operate. In Maryland alone we feel as though the economy has lost in excess of $285 million.

In summation, Mr. Chairman, unless we see a significant reduction, and I mean a significant reduction in intesest rates in the next 90 days, not only will the American dream of homeownership be a memory for a long time, but the entire economic base of this great Nation could be irreparably damaged for many years to come.

I thank you very much for your consideration today, sir.

Representative REUSS. Thank you, Mr. Porter.

[The prepared statement of Mr. Porter follows:]

Prepared Statement of R. Hursey Porter, Jr.

Mr. Chairman, I am R. Hursey Porter, Jr., from Salisbury Maryland, President of the Maryland Association of REALTORS®. Our Association, which is part of the NATIONAL ASSOCIATION OF REALTORS®, representing some 20,000 members throughout Maryland.

I want to thank you and the Committee for your concern for the very critical problem that we're experiencing today in high interest rates.

I am a real estate broker in Salisbury, Maryland, a small city on Maryland's Eastern Shore.

Many of my remarks today are not something you haven't already heard, but you will certainly hear a lot of over the course of the hearings and in the future. In my remarks, I hope I will reflect the effect that the interest rates are having on the home-buying and selling public -- not just the real estate industry.

The severity of the unprecedented high interest rates we have experienced especially over the past two or three months has devasted much of the housing industry already, and we feel in the real estate industry that it is now reaching a crisis stage as it will affect the entire economy.

As we all know, housing is one of the first areas to be hit by excessively high rates because of the long-term credit requirements of the buying public. Unfortunately, today over 90 percent of our citizenry cannot afford to buy a home. I venture to say that 70 percent cannot afford to refinance the homes that they are presently living in because of the high interest rates -- not so much because of the price of housing but because of the cost of financing that housing. The number of American homeowners late on their mortgage payments has reached the highest rate recorded since record-keeping began in 1953, according to statistics released by the Mortgage Bankers Association of America.

As I stated before, I am an active real estate broker in Salisbury, Maryland, and I would like to give you some facts as to what has happened to housing in our area. In Wicomico County, Maryland, particularly, sales are off 37 percent for the year to date, compared to 1980.

Mr. Chairman, last year the sales were off 25 percent. If we couple last year's off-sales and this year's off-sales, we have a combined total of over 50 percent off in sales from 1979. Today the figures show that housing sales in Wicomico County, Maryland, are

off 53 percent -- this August versus last August. To give you a further idea about another area of Maryland, the number of residential properties sold in the Baltimore metropolitan area in August was 31 percent lower than in August, 1980. The Greater Baltimore Board of REALTORS® reports that the number of residential units sold in August, 1981, was 963 as compared to 1,408 in August, 1980, representing a 31 percent decrease.

Recently, in testimony before this Committee's Sub-Committee, our Governor very clearly stated that there were insufficient funds in the Maryland Home Financing Program (tax exempt bond sales) to cover the demand. In our office alone, we submitted seven contracts for sale, pending that type of home financing, which was then available at ten percent. We had one individual selected out of seven. (Selection was made by a lottery system.) There were 14 potential home buyers turned in from Wicomico County for this form of financing.

I cannot stress to you the disappointment and the dismay on the faces of those unlucky individuals who had hoped to buy a home and were taking their chance on being drawn from that lottery.

Another interesting figure to look at today is the fact that over 70 percent of the sales in which my company is involved were negotiated using "creative financing". This is unconventional financing. We are not going to the banks. No one can afford 17 and 18 percent interest rates. Therefore, the majority of our sales are being made with owners taking back second mortgages, owners taking back first mortgages for periods of three to five years, or assumptions of the existing mortgages.

As president of the Maryland Association of REALTORS®, I can say very authoritatively that the figures that I've quoted for portions of Maryland will hold true for the entire State. I think, Mr. Chairman, that one-third off sales may be a conservative figure over the past two years. Again, if we couple the losses from 1980 versus '79 to the 1981 losses, as we are experiencing particularly this month, you may very likely find that the figures will show next month that housing sales were easily off 50 percent in the State.

As for the plight of the homeowner or the homebuilder who must sell his home, I want to say that it is a sad story indeed, when I say "must" sell his home. The discretionary seller is not in the predicament that the individual is in who has either lost his job or has been transferred. Every day in our office we are hearing the cries for help from the selling public, homebuilders, and the like.

Consider a situation where one has lost their job six months ago and has not been able to regain employment in his specified field and has approximately 30 percent equity in his home. HE cannot make his mortgage payments. And unfortunately, Mr. Chairman, he cannot sell his home because of the interest rate situation. His equity is dwindling, and he is on the verge of financial collapse, and in many cases facing imminent forclosure. This is the story we are facing every day in our industry.

New home starts are practically nonexistent in our area, as

we understand that they are practically nonexistent throughout the State. Many of our area's leading builders are literally closing their shops, or at minimum they are laying off 50 percent of their crews. Those with significant inventories may soon fold. They simply cannot afford to carry large inventories at 22 to 23 percent interest rates.

It's no longer a case of profits for the homebuilders. For them, it is how much loss and how long do they have to withstand it, and is there a light at the end of the tunnel. These are not companies that are marginally managed; these are well-managed companies with long, good reputations.

One of the largest and most successful homebuilders in the Salisbury, Maryland area, in business for over 30 years, reports that they normally build over 50 new homes annually. This represents $3 million to our local economy. However, this year, they have constructed only 8 homes, with 10 unsold units on the market and no sales since June 1, 1981. They are currently sitting with three foundations in the ground which will grow no further until interest rates lower and housing market activity increases. This builder refuses to go into the open money market and borrow money at 18 to 20 percent interest rates.

Mr. Chairman, to give you some indication of the concern of the citizens in my home town about record high interest rates, our local Board of REALTORS® secured some 3500 letters addressed to the Congress, the White House and the Federal Reserve Board in one afternoon on September 9, 1981. These letter represented a cross

section of our small business persons, agricultural interests and potential home sellers. This points out if the Congress and the Administration has not noticed, that high interest rates, not inflation, are our number one economic problem.

As for the real estate industry, well-established, well-trained professional real estate agents and brokers are having to leave our industry. This is an extremely serious matter. We have always alluded to the fact that the weak will fall out and the strong will get strong. This is not at all true today in the real estate industry. We have many people that have been considered over the years as the best of agents and brokers that have trained and worked hard and devoted their life to this industry, to be the tops in their field, that are having to leave it for one simple reason; and it is called bread and butter on their tables and supporting their families.

This, to me, is a devastation which is beyond repair, as far as our industry is concerned. I sincerely hope that this Committee will consider all the facts I have presented. I offer the following suggestions, as perceived by the real estate industry, as helpful solutions to the high interest problem.

First of all, we hope there will be further reductions in federal spending, thus reducing credit demands by the Federal Government.

Secondly, we are hoping for immediate attention by Congress to the plight of the Nation's thrift institutions, and the adverse

effects that the money market funds are creating upon our economic system. There is no reason today, Mr. Chairman, for yields of 18 to 19 percent to be given when we have a true inflation rate of 7 to 8 percent. With the advent of the All Savers Certificates on October 1, we hope this will give immediate relief, while realizing this is only a temporary measure.

Thirdly, the Federal Reserve System must act quickly -- and I mean quickly -- to reduce the stranglehold on this pent-up economy. The tourniquet to the throat is not a cure for a bleeding finger, and this is the way the real estate industry feels today -- that the tourniquet is around our throat and around the throat of one of the most productive segments of our economy.

The NATIONAL ASSOCIATION OF REALTORS® Economic and Research Division estimates that over the past 34 months there have been 2, 494, 000 lost existing home sales, due to the erratic fluctation of interest rates and other related economic factors. These 2.4 million unsold units represent a loss to our economy of 175.6 billion dollars.

In Maryland alone the NATIONAL ASSOCIATION OF REALTORS® estimates 40,800 resale units unsold, representing a loss to the Maryland economy of 3.5 billion dollars.

Further, according to the NATIONAL ASSOCIATION OF REALTORS®, the economic benefit to a given community of a typical resale transaction of an existing home (not new construction), is

5,000 - 7,000 dollars. This figure includes:

(A) Pre-sale fix-up expenses .....$500 - $1,000

(B) Expenditures at time of sale.....$2,500 - $3,500
(Moving expenses, surveys, legal fees,
and local government fees and taxes)

(C) After-sale expenditures .....$2,000 - $2,500
(Capital improvement, furnishings,
paint, etc.)

Therefore, in a community where normally 100 resale transactions would occur annually, there is a direct loss of nearly 3/4 of a million dollars due to lack of home sales.

Let's go back to the 2.4 million unsold units and multiply those by $7,000 and it's clear to see these past 34 erratic months have cost our local economies over 17 billion dollars. In Maryland local economies have lost in excess of 285 million dollars.

In summation, Mr. Chairman, unless we see a significant reduction in interest rates in the next 90 days, not only will the American dream of home ownership be a memory, but the entire economic base of our Nation could be irreparably damaged for years to come.

Thank you, Mr. Chairman. That is the conclusion of my remarks.

Representative REUSS. Senator Sarbanes, your constitutents have presented some tragic testimony here. I have heard this from my own people in Wisconsin, but Mrs. Reeves and the four gentlemen with her have presented it very dramatically, and I will see that it is at least sent to and I would hope read by the administration.

There were so many interesting little points that were made. Mr. Grady made the point that he needs electronic equipment for emission controls testing, and that he was fortunate enough to enter his business after he had made a success of his life earlier and to put some capital in and has something in a money market fund, and he is willing to give up his high rate of interest in the money market fund to put that in, but he can't do it with his savings alone. And he simply can't pay a bank 22 percent to make up the needed residue, what he has to pay, and possibly ever make it back. So he is on the margin. And the people of Maryland don't get a very useful emission control service that they ought to be having at a reasonable price, which Mr. Grady was trying to do.

Mr. Porter, I was particularly interested in the point you made of another one of the very many forgotten Americans, the American who has to sell his home because he is moving someplace or for another reason, maybe he is ill. He can't do it. As you point out, only the upper 5 percent of Americans today can buy a home. So how can anybody sell one?

And, Mrs. Reeves, you with your husband maintain a farm in Maryland, and you have told of the absolute necessity farmers have to get credit from seed time to harvest time. The American farming economy operates on the ability of a farmer to borrow money at a reasonable rate to tide him over until he gets his or her return from the finished product. And that whole basis upon which the farming economy rests has now been knocked out, and that is a tragedy too.

And, Mr. Poretsky, among many interesting things you had to say was the terrible waste to our economy of disbanding homebuilding crews that may have been in existence for a generation doing workmanlike, artisanlike work. They're cast to the winds. They're never going to be reassembled again. This is over and beyond the personal hardship on the people in your industry which is a consideration too.

And, Mr. Cairns, in your field, the automobile sales, you pointed out that while, of course, the first modest shock may have knocked out of the industry marginal operators who perhaps didn't deserve perpetual life in the automobile distribution industry, now what is happening is that some of the oldest and finest automobile agencies that have perhaps been a family since the beginning for two or three generations, are going under, and what purpose is served by that I can't fathom.

So that you all have given us a composite that should fortify the determination of people like Senator Sarbanes and myself to do something about it.

I would hope that you who belong to great national associations, and I'm thinking of our friends from the realtors and the homebuilders, could get your sensible views into the national policymaking bodies of your organizations. They have been good, I will concede in saying, "Yep, the Government ought to cut out waste and fraud in its civilian programs," and I couldn't agree with that more,

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but I think that with all respect, those national organizations, if they really want to see interest rates come down, have to be a little more forthcoming and forthright in saying that insane expenditures for military hardware are just as destructive as supporting welfare fraud, let us say. And I would hope that they would say that $750 billion of tax reductions in the period ahead is going to produce unsupportable budget deficits and therefore we ought to look at whether it was really necessary to distribute untold new billions to the oil industry and to make the general focus of our tax cut the wealthiest 5 or 10 percent of our population. And whether it isn't time to look again at the foolishness which we perpetuated in late July, because otherwise we are just going to continue to have bad deficits and higher and higher interest rates.

And then finally, Senator Sarbanes made what I thought was an excellent point before. That is, that really when you look at the American financial system pouring out money to the commodity speculators by way of credit, pouring out credit to the conglomerators and corporate takeover artists, so that there isn't anything left except at frightful costs for the farmer and the homebuilder and the realtor and the gas station proprietor, and the autodealer.

It might be that your organizations should be demanding of this administration which got us where we are today. Look at it: Mortgage rates up; bond rates up; municipal bond rates up steadily. Your organizations ought to be making the point to this administration that they can do what every other democracy in the world does, try to get the banking system to focus its loans on worthy things like automobile dealerships and filling stations and realtors and homebuilders and farmers and capital investment, generally, rather than to see it all squandered on speculation and takeovers.

Well, Senator Sarbanes, you have rendered a notable service to this committee by convening this panel. I'm grateful to you.

Senator SARBANES. Well, Mr. Chairman, thank you very much. The people who are here are but the tip of the iceberg. We heard comparable testimony all across the State.

There are just two or three points that I want to develop, and if you will indulge me for just a moment, I would like to ask first Mr. Grady a question, because he is really one of the best small business people we have. You know, we seek to encourage efficiency and productivity. That is the way we get a rising standard of living. Mr. Grady, I gather from your testimony that, confronted with these high interest rates, you are not able to make the investments you think are wise. These rates actually prevent you from becoming a more efficient and a more productive operator.

Is that the case?

Mr. GRADY. Yes. And of course, I didn't want to take the time, Senator, other potential threats that would get into the expense of running my business could force us to lessen the services that are available to the driving community.

I think we are all aware of the fact of a major oil company making a move November 1 to charge its dealers for carrying a credit card. Now if that happens in the State of Maryland, where it is against the law for me to charge for credit, I just wouldn't know where to go to carry the additional cost, in my case, $30,000 a year.

So we just spoke of a few things here. I had the example of the current loan with me, but the pressures are tremendous. I would guess that I know personally six or seven dealers who have thrown in the towel since the first of the year.

Senator SARBANES. It is interesting to observe, Mr. Chairman, that the oil companies which got a major tax concession in the bill are nevertheless now turning around and squeezing their dealers in a way that shifts additional pressure onto small business people, additional pressures which they are not able to withstand.

Representative REUSS. And making very handsome profits, much of which they put not into energy, but into mail order houses and circuses and other unrelated profitable activities.

Senator SARBANES. And I want to ask Mr. Cairns and Mr. Poretsky this question, because I think it is a very important point: Are the people now being squeezed out, really some of the best in the business; is that the case? There was a point when you looked around and saw someone close out that you said, "Well, perhaps they shouldn't have been in to begin with. They were undercapitalized. They weren't very efficient. They really weren't very good."

But today's testimony, as I understand it, is that now some of our very best, well-established, old-line businesses either are being squeezed out or are saying, It's not really worth our continuing. We are simply going to get out, liquidate our capital, and take whatever we can get in the money markets. We're not going to stay in the business as a productive enterprise.

Is that what you see happening?

Mr. CAIRNS. That is very true, and when one of these facilities close their doors, they are employing an awful lot of people in the small communities where they are the businessmen of that stature. He can't control his own destiny any more. At one time if a guy went broke, he probably bought a house larger than he could afford or a boat bigger than he should have, but in today's market, it is not that reason for him going out of business at all. It is because he was geared to pay 8, 9, or 10 percent interest, and today he is paying 20 or 22 percent. He can't control his own destiny.

Mr. PORETSKY. That is very true. In housing, the 1973 and 1974 downturn took care of most of the weaker builders, those that you described, and what few came into the building market since that time have long been gone.

Senator SARBANES. Well, I want to thank you all. Mr. Chairman, I am pleased that these witnesses were able to come before the committee, and as I said, they are really but a representative sample of what we heard all across the State.

Representative REUSS. Mr. Cairns, Mr. Grady, Mr. Poretsky, Mr. Porter, Mr. Reeves, we are most grateful to you, and thank you, Senator Sarbanes.

Mr. PORETSKY. Mr. Chairman, is there a chance to respond to a couple of your comments you made directed to what the national association has been doing at this level?

Representative REUSS. Please proceed.

Mr. PORETSKY. I would like to point out a few instances, if you have just a moment.

Specifically, yesterday, the president-elect of the National Association of Home Builders was in these chambers and made a few recommendations, which we have been consistently maintaining for the last few weeks. Perhaps even months. But we have called upon the administration and Congress to hold the line on the Federal deficit at $42.5 billion, even if accomplishing that goal would mean a reduction in Defense and involving a deferral of the income tax reductions already approved by Congress.

We have stated and made the request based upon what we had heard, first of all, in meetings we have had with the Federal Reserve Chairman Volcker and then more recently with the Reserve Board Governor Schultz, that their insensitivity to perhaps what statistics really relate to in terms of lives, that perhaps it might be in the potential of this committee, if you are the people who will be reviewing the nominees for Governor Schultz' future seat, that consideration be given to representation on the Board of Governors to a member of the small business community, that sector of the economy which is most sensitive to the credit tightening policies.

In addition, we have had—our immediate past president met with Ed Meese 2 weeks ago. We asked him many questions. He simply said "Watch the television screen, and we will help to get interest rates down." I didn't hear one sentence last night about the poor homeowner who couldn't buy a house, any regard to interest rates, but we have specifically hammered and hammered again at all of the people that we have contact with to increase the budget cuts to balance the budget.

We, as I alluded to earlier, would like to see the money market funds regulated. We are not in favor of regulations, but I think that is the best bet. If you have something that looks like a duck and walks like a duck and acts like a duck and sounds like a duck, let's treat it like a duck.

These people are taking 40 percent of their money, I understand, out of this country to Eurodollars. They are destroying what potential capital pool there is. We have asked and said time and time again, how, with the inflation rate going down, there is no reason for that interest rate to be where it is today.

We have specifically asked for potentially class exemption on pension funds to try to get pensions into mortgages. We have encouraged, as you mentioned earlier today, greater use of tax-exempt bonds. All we heard from Reserve Board Governor Schultz last week was, "Well, all we want you to do is maintain pressure on your industry to Congress to balance the budget."

And if that's all I can hear from a Federal Reserve Board Governor—that is why today I was so delighted to talk to you people and say, "We all have to work together," not just simply say what our associations are doing. I think that we have had to grow up very quickly, and we've done a very good job of it in the last few years. And we have the technical expertise, as well as the political input that is required. We have also elected you people to do the job that we can't do. And I have a business to run, what little is left of it, and we do need your help.

And I very much appreciate the understanding that you have given us today.

Representative REUSS. Well, I'm glad to hear the new stand adopted by the Home Builders, as you say, in the last few weeks, which I wasn't familiar with. And I will say you are on the right track. And the point, as you have just explained it, that budgetary control involves, of course, maintaining control over civilian spending, but it also involves maintaining control over military spending and maintaining control over the amount of revenue reduction that may be inherent in a tax program.

So with that balance, I find your views very sympathetic. And on that note of hope, because it is about all we have to live on, let me thank you all for coming.

And the committee is now in adjournment.

[Whereupon, at 11:20 a.m., the committee adjourned, subject to the call of the Chair.]

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